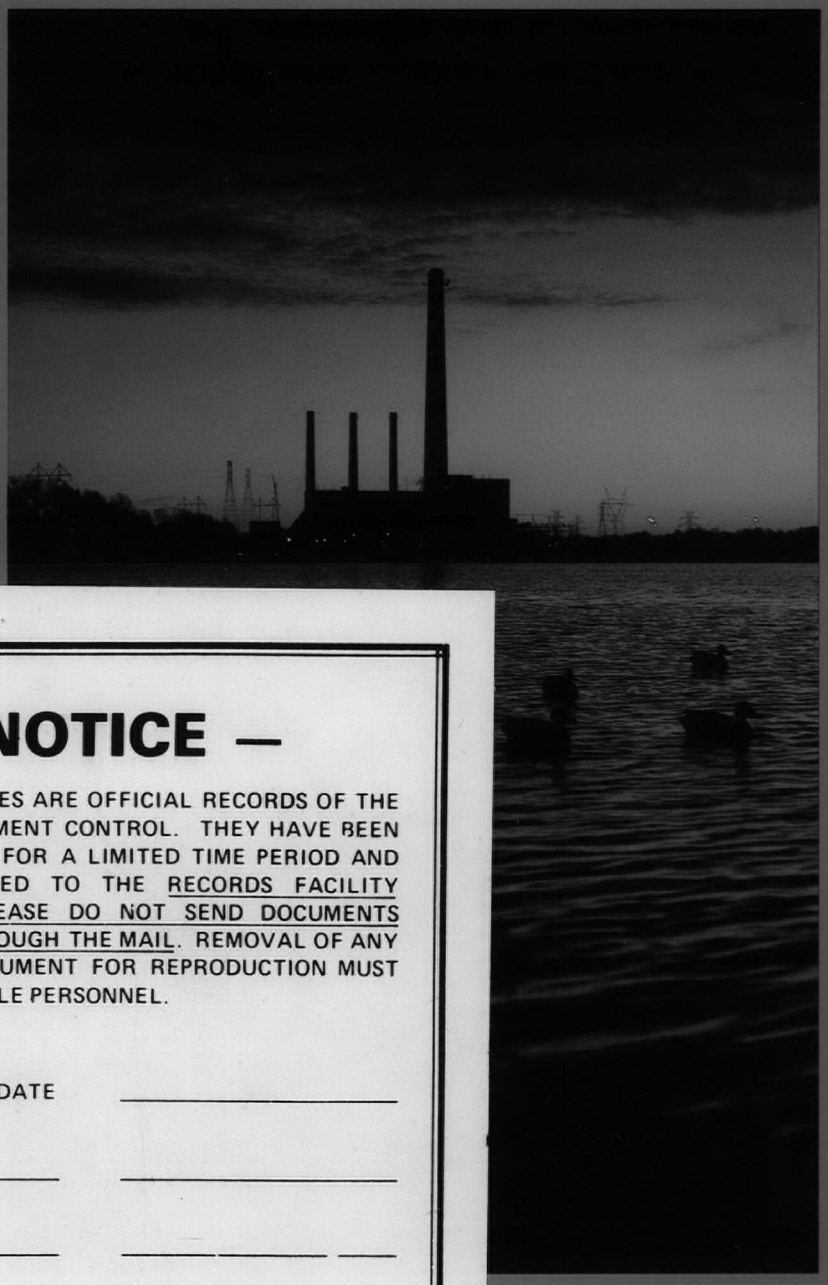


Northern States Power Company

Nineteen Hundred and Eighty-Five Annual Report

nsp (Northern States Power Company) provides energy to customers in parts of Minnesota, Wisconsin, North and South Dakota and Michigan's Upper Peninsula. The company generates, transmits and distributes electricity to more than 1.2 million customers and distributes natural gas to almost 308,000 customers within its 49,000-square mile service territory. NSP also supplies telephone service in Minot, N.D., and process steam.

Cover: A new day begins at the Black Dog generating plant south of Minneapolis. Projects at the plant, including conversion of a unit to a fluidized bed boiler, preparation to receive coal by railroad and a study of modifications to burn refuse derived fuel, typify NSP's efforts to build on its experience to provide customers with reliable energy at the lowest possible price. The plant is located on the Minnesota River near a national wildlife refuge.

Electric Service Area

Electric and Gas Service Area

Major Cities

1 Sherburne County (Sherco)
(Coal) 1,402 Mw

2 Monticello
(Nuclear) 538 Mw

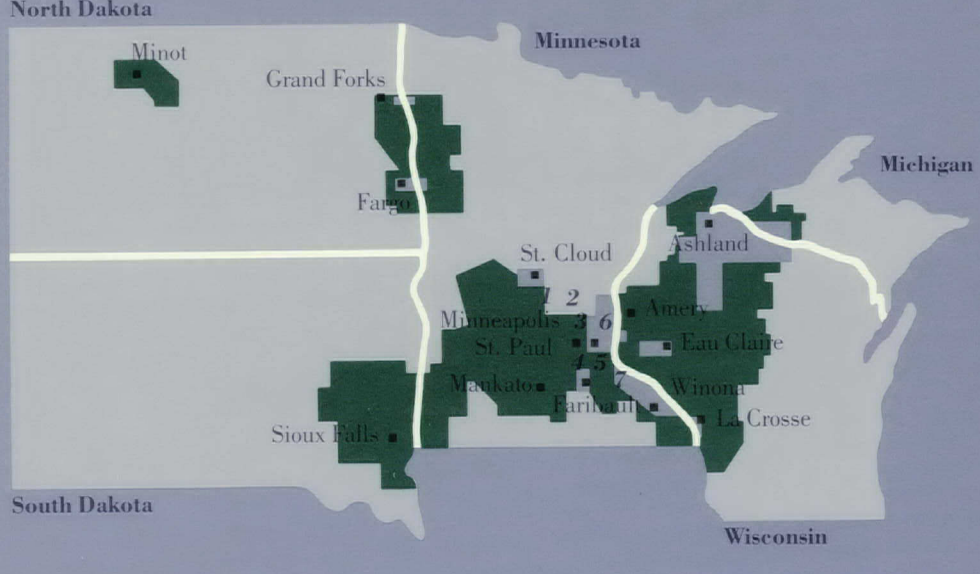
3 Riverside
(Coal) 309 Mw

4 Black Dog
(Coal) 422 Mw

5 High Bridge
(Coal) 347 Mw

6 Allen S. King
(Coal) 560 Mw

7 Prairie Island
(Nuclear) 1,009 Mw



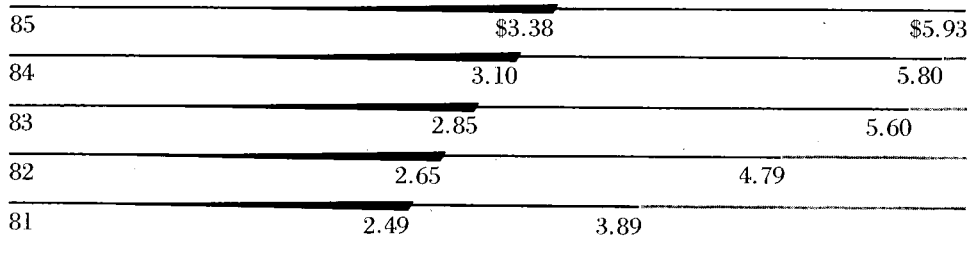
Highlights	Year ended December 31 1985	1984	Percent Increase
Earnings per share	$5.93	$5.80	2.2
Dividends paid	$3.38	$3.10	9.0
Return on equity	15.6%	16.4%	
Revenues (millions)	$1,788.7	$1,775.6	0.7
Assets (millions)	$4,047.6	$3,741.7	8.2
Customers (thousands)	1,541.4	1,514.6	1.8
Benefit employees	7,414	7,347	0.9

p1

Contents

Dividends Paid

Earnings per Share



*34¢ subject to refund.

Don McCarthy, seated, with Bruce Richard.

p2

Overall, 1985 was another excellent year.

Earnings of $5.93, with an annualized dividend rate of $3.52, are the best our shareholders have seen. The stock price climbed to 54¾, a new high, and in 1986 it continues to climb. Even with interim rates in effect for many customers, our electric rates remain among the lowest in the country and our natural gas rates are at the national average. Opinion polls confirm customer satisfaction with the reliable service we deliver every day. We sold more electricity and gas than ever, and our subsidiary, NORENCO, continued to progress.

A disappointment was the Minnesota Public Utilities Commission (MPUC) decision to rescind its December order granting NSP an annual $17.1 million, 6.03 percent, natural gas rate increase. NSP had asked the MPUC to redeliberate its December rate decision because of the appearance of a conflict of interest when NSP discussed job openings with, and then hired, a retiring commissioner. The MPUC then dismissed the entire gas rate case and ordered NSP to refund interim rates collected since last April. This amounts to 11 cents per share in 1985.

We believe NSP's actions did not affect the MPUC's original rate order, which is based on the recommendations of an independent administrative law judge. NSP has asked the MPUC to reconsider its Jan. 29 order. If it does not, NSP will appeal the dismissal.

Higher gas and electric operating expenses, an increased rate base resulting from completed generating plant renovations and government-mandated conservation programs led NSP to request gas and electric rate increases for many of its customers–the first major rate cases since 1981.

We are seeking an annual electric rate increase of $121.7 million, 12.68 percent, for Minnesota customers; the MPUC will rule by June. We also asked for rate increases for Wisconsin electric and gas customers.

NSP continuously moves forward in improved service, more efficient electric generation, better cost controls, cleaner power plant emissions and greater generating capacity. This year's report concentrates on how NSP is achieving these goals.

Each project builds on the experience and expertise of our employees. We dedicate this report to them. Their commitment and knowledge are responsible for NSP's outstanding achievements and reputation as an industry leader.

Our several construction and generating plant renovation projects are proceeding smoothly. Construction of Sherco 3 (NSP has a 472-megawatt share) and redevelopment of the Jim Falls hydro plant site to 50 Mw are under budget. When we start up Black Dog unit 2 this June, it will be the nation's largest fluidized bed boiler.

NSP has contracts with three counties to process their refuse, and we are negotiating with several others. NSP is building a resource

recovery plant to process refuse derived fuel (RDF) and is modifying two older power plants to burn it. RDF is an economical fuel for NSP. We also are proud to help solve the communities' waste disposal problems.

Our marketing efforts designed to benefit customers are paying off: Electric and gas customers are taking advantage of conservation and load management programs; conversions to natural gas for water and home heating are increasing; and NORENCO has several energy services contracts and commitments for cogeneration projects.

NSP plants performed excellently and were available for service far more than the industry averages for both coal-fired and nuclear units. The Monticello plant's availability was 89 percent after coming back on line in January 1985 following a year-long maintenance outage.

Customers demand quality service, and NSP delivers. To improve service further, NSP stepped up its tree trimming program, reducing tree-related outages–a large share of service interruptions.

Our commitment to the environment continues. Sherco 3 will have the best pollution control equipment available. Black Dog's fluidized bed will virtually eliminate sulfur dioxide emissions. We've extended our commitment to buy clean, low-cost Canadian hydropower.

Customers and the communities we serve benefit from our employees' tradition of volunteer service. Employees also increased their contributions to area United Ways by more than 10 percent.

At their January 1986 meeting, your directors voted to ask shareholder approval at the annual meeting to authorize additional shares of common stock. If approved, the company intends to split its common stock.

The directors took this action because of their confidence in the economic strength of our service area, NSP's strong financial position and their desire to have the stock at a price level that encourages more customers to invest in NSP. Our common stock has been trading above $50, about double the average utility stock price.

Throughout the year the directors represented well the interests of shareholders and customers with thoughtful guidance and counsel. Their overall attendance record at board and committee meetings was 93 percent. We deeply appreciate their involvement.

1985 was a successful year; we look forward to 1986. Building on our experience and excellent public record, we will strengthen customer confidence and trust in NSP and be an even better company, more aware of our responsibilities and public demands.

Sincerely,

Donald W. McCarthy
Chairman of the Board and
Chief Executive Officer

Bruce A. Richard
President and
Chief Operating Officer

March 3,
1986

Creative, experienced employees build toward future

BUILDING ON EXPERIENCE

To the growl of diesel engines, the clang of hammers hitting steel and the shouted instructions of supervisors, construction crews shape the energy future of NSP at building sites and generating plants throughout its service territory. In offices, other NSP employees also are shaping the company's energy future through discussions with customers, fuel price negotiations and power purchases.

Several construction projects are under way as the company prepares for future electric requirements and takes advantage of technology and innovative ideas. Each project builds on the experience of NSP and its employees to get the job done right–efficiently, safely, cost-effectively and timely.

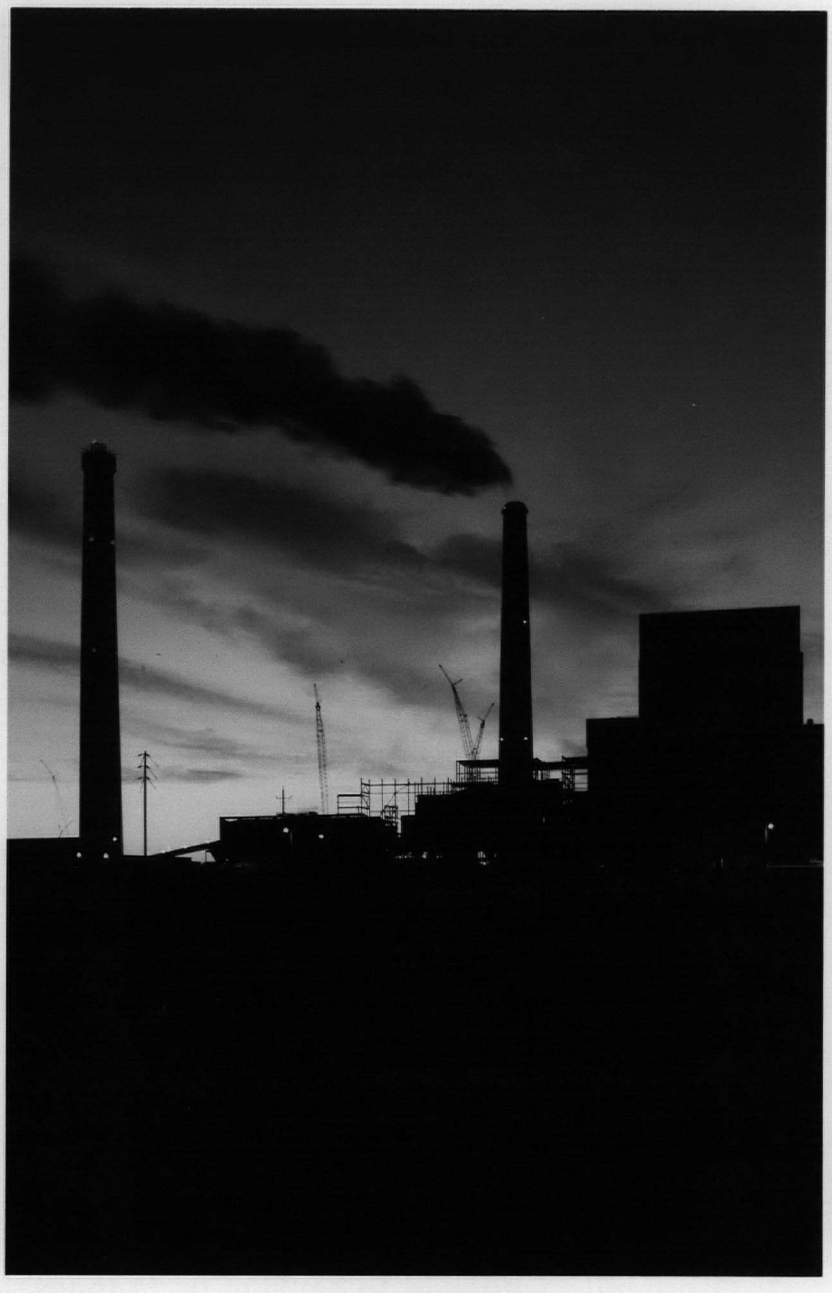
Almost 50 percent complete, constrnction of Sherco 3 is $82 million under budget and two months ahead of schedule. NSP shares ownership of the $1.1 billion facility at Becker, Minn., with the Southern Minnesota Municipal Power Agency. NSP will have 472 megawatts (Mw) of Sherco 3's capacity, while Southern Minnesota will use 328 Mw.

Sherco 3 will burn Western, low-sulfur coal. Its pollution control system will remove 90 percent of the sulfur dioxide and 99.8 percent of the dust particulates from emissions when it begins service in November 1987.

Sherco 3 is the only new NSP plant under construction. The company is studying the economics of building a coal-fired unit in one of the Dakota states and another in Wisconsin. The probable start-up dates for these units would be in the mid- to late-1990s.

As with its other projects, NSP draws on the considerable power plant construction experience of its employees and contractors, many of whom honed their trades on NSP plant projects in the early 1970s. NSP serves as both construction and overall project manager. This streamlines decision-making to keep projects on time and within budget.

Redevelopment of the Jim Falls hydro plant site on the Chippewa River in Wisconsin is 15 percent complete and running $12 million under budget. Design changes and competitive equipment and construction bids lowered the cost to $100 million.



Day comes early at Sherco
where NSP is building a third coal-fired
unit. NSP is an industry leader in pollution control.
Sherco 3 will burn 100 percent, Western, low-sulfur
coal and will use the best pollution control
equipment available.

Modifications improve performance and extend operating lives

Redeveloping the site quadruples the capacity to almost 50 Mw. NSP expects the new Jim Falls to generate electricity beginning in late 1988.

Conversion to a fluidized bed boiler will improve the efficiency and reduce emissions of unit 2 at the Black Dog plant south of Minneapolis.

A fluidized bed limits emissions so well that the plant will not need costly pollution control equipment. It also can burn alternate fuels efficiently, such as processed trash and peat.

Modifying the boiler to a fluidized bed will increase the unit's capacity by 40 Mw–to 125 Mw–and is expected to extend its operating life by 20 years. NSP tested the technology at the smaller French Island plant in La Crosse, Wis., before beginning the $58 million Black Dog project.

Reliable electricity at the lowest possible price is part of NSP's corporate mission. The company believes it can do this best by extending the useful lives of generating plants to the maximum.

The Jim Falls redevelopment and Black Dog boiler conversion are prime examples of NSP's life extension policy and the actions that will keep the company competitive.

The emphasis is on renovation. The company first replaces minor parts when they wear out, then installs new major equipment at a facility. At the same time, NSP strives to improve the facility's efficiency, availability, health and safety aspects, environmental effects and, in some cases, generating capacity. When NSP must retire the plant, the company will reuse the site.

Monticello returned to service in January 1985 after almost a year out of service for extensive refurbishing. Crews replaced or overhauled major equipment at the nuclear generating plant, including recirculation pipes, condenser tubes and the low-pressure turbine generator rotors, increasing NSP's investment there by more than $115 million.

Monticello consistently receives high performance ratings from federal agencies and industry organizations and is one of the most productive members of NSP's generating team. NSP, with the U.S. Department of Energy and industry groups, is studying the prospect

Company combines experience, new technology for improved operations

of extending Monticello's life 10 to 15 years beyond 2007, when its operating license expires.

Much of the study centers on the experiences of engineers and plant employees who are familiar with the unit's equipment and service history. The study will help NSP and other utilities determine the relative advantages and costs of nuclear plant life extension over new construction.

The Riverside plant has been around a long time and will generate electricity many more years under a life extension project. Two units at the Minneapolis plant will begin life anew in mid-1987 with retrofitted boilers, a new computer system and a shared, new and improved turbine generator.

The $56 million project, done in existing space at the plant, increases the combined unit's capacity by 50 Mw and enables NSP to retire three older units at the facility. The retrofitted boilers also will produce less sulfur dioxide and other emissions.

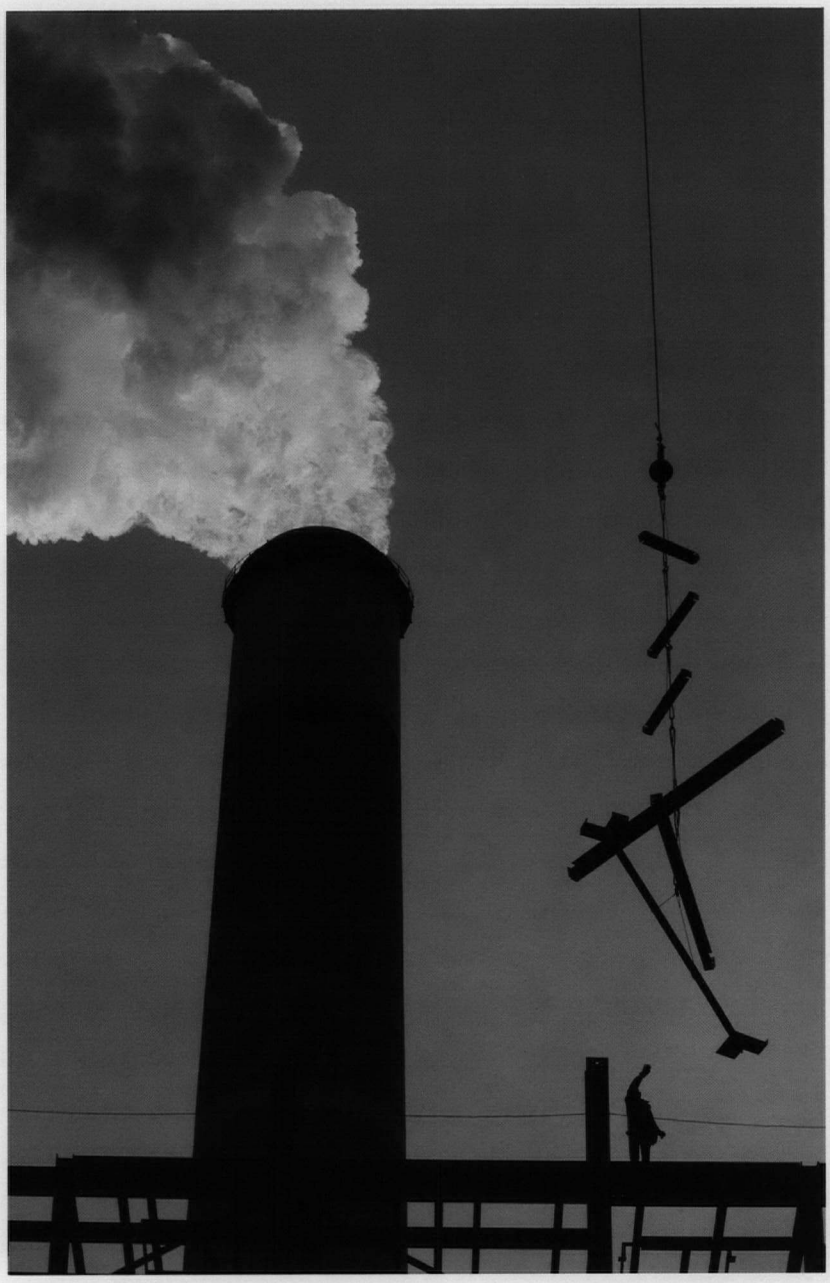
Even instrument control equipment can have a longer lifespan. During scheduled outages at the Prairie Island nuclear plant, $25 million worth of control room equipment was repaired and refurbished. While components maintenance is routine, NSP was the first utility in the country to do a project this size.

Technicians refurbished parts still in good condition and replaced others. The project saved NSP more than $4 million in equipment replacement costs alone and guards against equipment failure that could lead to costly outages.

Trash will soon join the fuels NSP burns to generate electricity. The company in July broke ground for a $25 million resource recovery plant and made plans for another that will process refuse derived fuel (RDF) to burn in power plant boilers.

So far, three Twin Cities area counties have signed contracts with NSP to process their municipal solid waste, about one-third the area's total waste volume. The company continues negotiations with others in Minnesota and western Wisconsin.

Entry into the municipal solid waste disposal business is a logical step for NSP. RDF is an available, low-cost, clean-burning fuel source. Modifying generating units to burn RDF is a relatively



NSP's achievements result from the hard work of dedicated, highly skilled employees and contractors. NSP builds on their experience for new ideas, quality service and top-notch operations.

Rigorous maintenance provides reliability customers expect

low-cost way for NSP to make the most of its smaller, standby plants.

Burning RDF has obvious advantages for NSP. Local governments and area residents also benefit. The refuse-to-energy process reduces significantly the amount of solid waste needing disposal and helps Twin Cities area counties meet a legislative deadline prohibiting landfill disposal of unprocessed waste after 1990.

Beyond the construction projects, NSP builds on its energy experience to provide customers with reliable service at the lowest possible cost. With its experience and employees' expertise, NSP helps customers make the appropriate energy choices and develops services to meet their unique needs.

Marketing its experience also gives NSP an active role in the demands put on its energy system. By encouraging conservation and wise use, NSP maximizes use of its facilities.

NSP does this with rebates for energy-efficient equipment, special rates for off-peak electric, gas and telephone use, low-interest conservation loans, cogeneration projects and energy services contracts.

NSP, working with other companies, has modified a locomotive engine to run on clean-burning natural gas. Extending its gas expertise to non-traditional areas, such as transportation, benefits customers with innovative, efficient energy use and a broadened customer base that helps keep rates low.

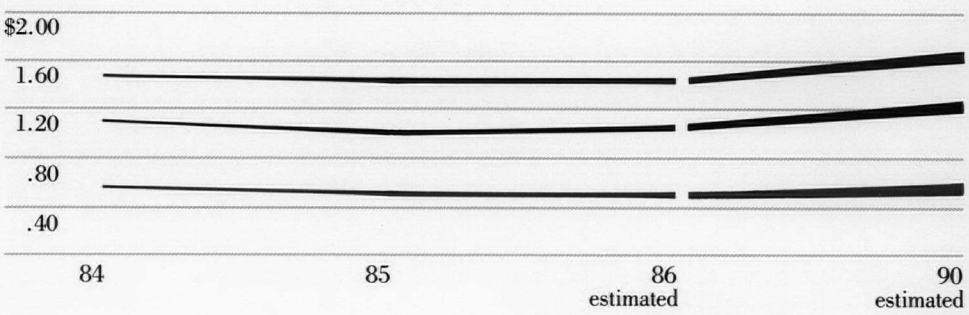
Fuel costs have a tremendous impact on the price of electricity. NSP has turned this effect into a favorable one. Extensive negotiations, long-term planning and careful research help NSP keep a lid on fuel costs. NSP pays consistently less for its fuel than the industry. With the help of competitive transportation, coal, uranium and uranium enrichment markets, NSP in 1985 paid less to

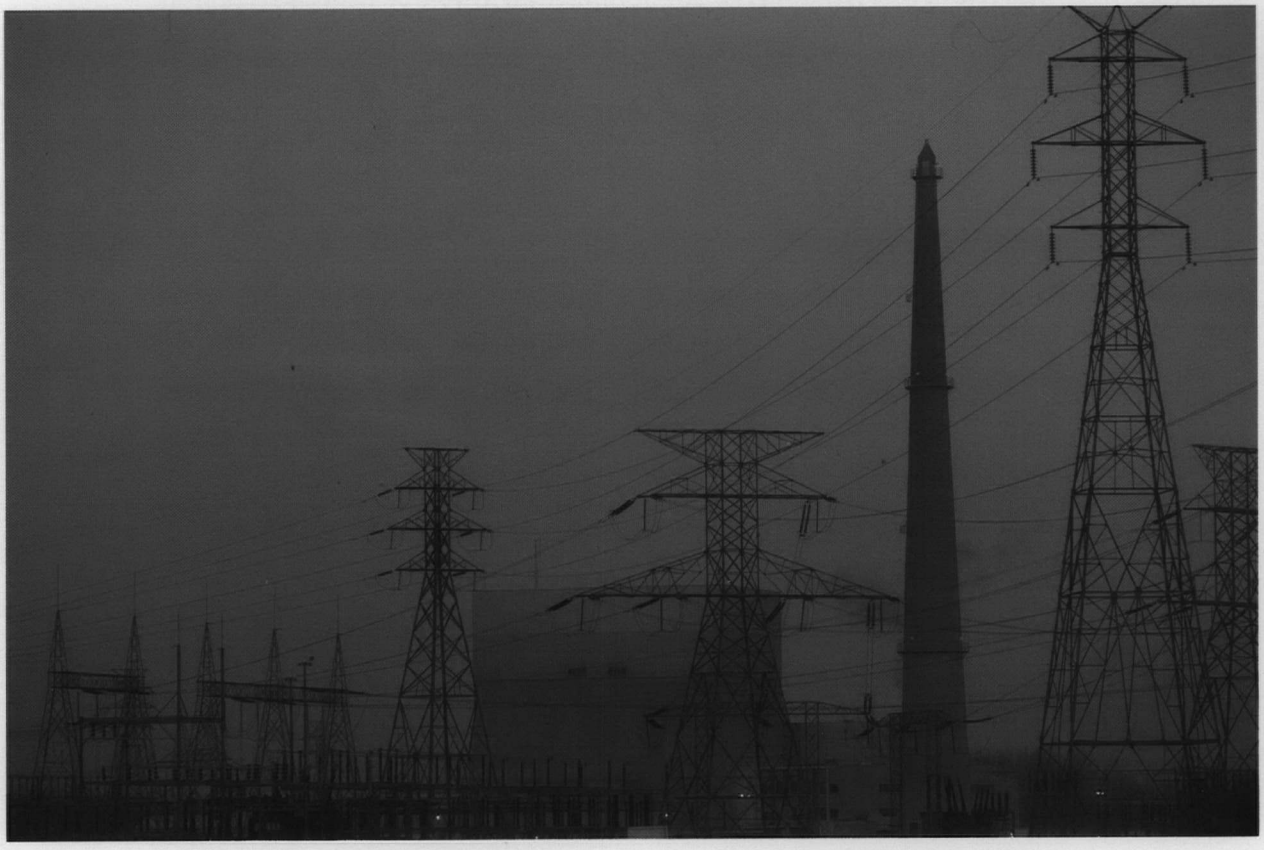
Fuel Costs per MBtu

Coal

Nuclear

All Fuels





The Monticello nuclear plant returned to excellent service in 1985 after a year-long outage for extensive refurbishing. Since coming back on line in January, Monticello was available for service 89% of the time, far above the industry average.

Economical energy sources keep rates low

fuel its generating plants than it did in 1984.

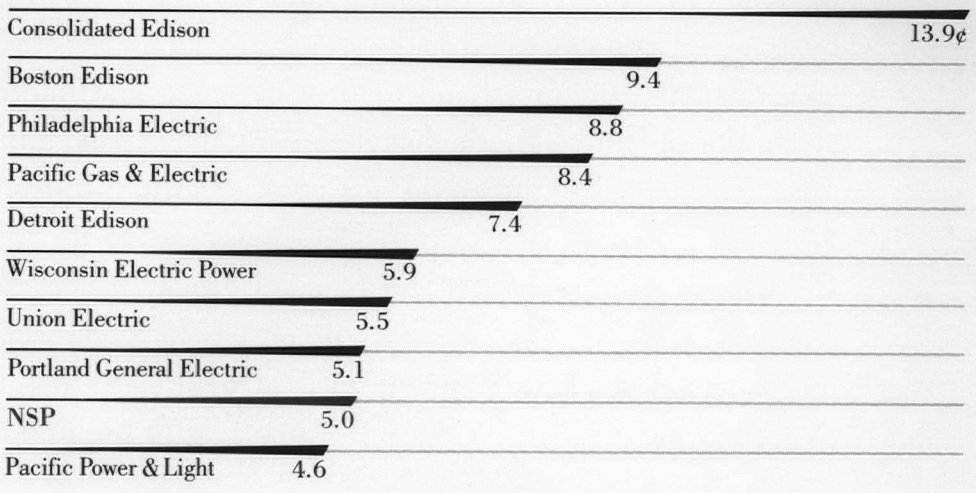
To further reduce this cost, the Allen S. King and Black Dog plants this year will begin receiving low-sulfur Western coal by rail car rather than river barge. The move will save NSP, and customers, up to $90 million over the next 15 years in transportation costs.

NSP makes the most efficient use of its own facilities, and also turns to other producers for low-cost energy. The company in December 1985 announced plans to purchase a 207-Mw share of a Minnesota Power plant and to buy an additional 102 Mw of electricity for 17 years from a Minnesota Power source in one-third increments beginning in 1989. The utilities would transmit the power over existing facilities.

The power and plant-share purchases from Minnesota Power are less costly than if NSP were to build the capacity itself or buy it from other sources. NSP also has major power purchase agreements with the Manitoba Hydro-Electric Board through 1992 and 2004.

A U.S. Department of Energy report for 1984 documents NSP's efforts to keep its prices competitive. Of the 50 major investor-owned utilities in the nation, NSP had the smallest growth rate in retail electric prices in the last 10- and 20-year periods. NSP electric rates remain among the lowest in the nation.

Electric Revenue* ***per kwh***



*Includes fuel cost adjustments and city fees, excludes state sales tax.

Financial performance achieved with reasonable rates

1985 was another good year financially for NSP. • Dividends increased by 8.6 percent to $3.52 annually; • the stock price again hit a new high—from last year's $44¼ to $54¾ this year; • earnings per share were up 13 cents to $5.93; • return on equity was down slightly, from 16.4 percent to 15.6 percent, but was well over the 14 percent industry average; • credit quality remained high, with bonds rated Aaa by Moody's, AA+ by Standard & Poor's and 2 by Duff & Phelps.

The company achieved these financial results while maintaining competitive electricity prices. In 1985 the price of electricity for the average retail customer was a shade under 5 cents per kilowatt-hour; the national average was 7 cents.

NSP's goal is to provide shareholders a reasonable return on their investments and keep the cost of money at a minimum while maintaining a flexible financial position. This in turn benefits customers through favorable rates and a company financially equipped to meet their needs. NSP met virtually all of its financial objectives this year.

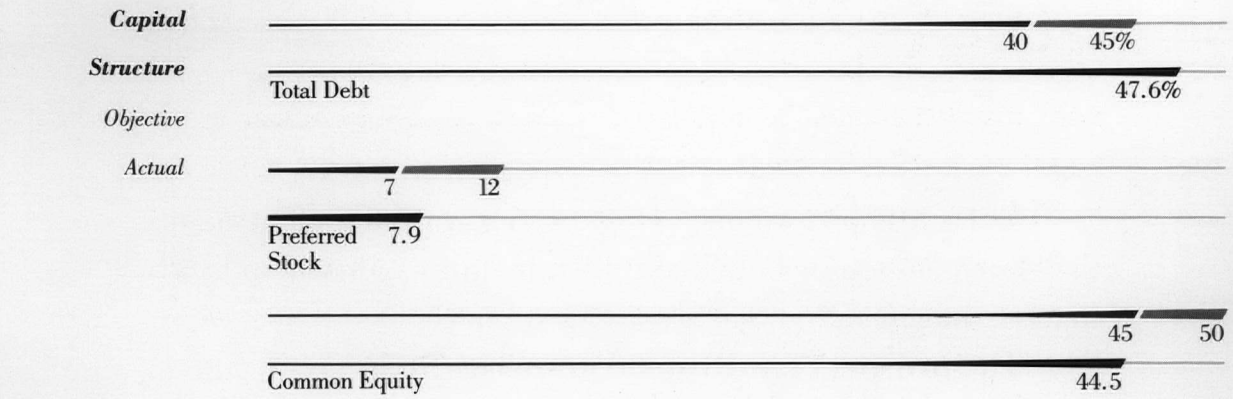
Bond ratings reflect credit quality and can be critical to a company's ability to build for the future. Also, with a financially strong foundation, companies are better able to compete in the marketplace.

In general, this is true for all kinds of businesses. It is especially relevant to the utility business in its increasingly competitive business environment.

Capital structure, bond interest coverage and internal cash generation are three criteria that greatly influence bond rating agencies' decisions as to the credit quality of electric utilities.

NSP's capital structure in 1985 was close to its objectives. Debt, both short- and long-term, made up 47.6 percent of the company's 1985 capital structure; preferred stock was 7.9 percent and common stock represented 44.5 percent. NSP has tentative plans to issue preferred stock in the next year or two that will help bring down debt levels.

Interest coverage was within NSP's objective range at 4.2 times the interest charges at the end of 1985. The company's



objective for pre-tax bond interest coverage without Allowance for Funds Used During Construction is 3.5 to 5.0 times the expected interest charges.

NSP's objectives for capital structure and bond interest coverage are consistent with rating agencies' guidelines.

A third factor important to credit quality is the outlook for financing needs. The more funds that NSP can generate internally without selling stock and bonds, the better. NSP's long-range plans are for about 82 percent internal cash generation for the next five years, with 18 percent of its cash needs met through the sale of securities. This amount of external financing should be manageable and will not strain the company's credit position. In addition, because of its good ratings, the company can borrow at favorable rates.

Earnings per share (EPS) and return on equity (ROE) again met NSP's objectives for five-year averages: • EPS should exceed the electric utility industry's average growth rate; • ROE also should exceed that of the industry; • ROE should approximate returns earned by U.S. industry.

Earnings per share grew at an average rate of 13.4 percent over the past five years, compared with about 6 percent for the electric utility industry. NSP's rapid earnings growth occurred as earnings rebounded from their depressed levels in the late 1970s and 1980.

The escalated pace, however, has peaked and, as seen this year, future growth rates most likely will not match those of recent years. Earnings per share in 1985 increased 2 percent over 1984.

Return on Equity

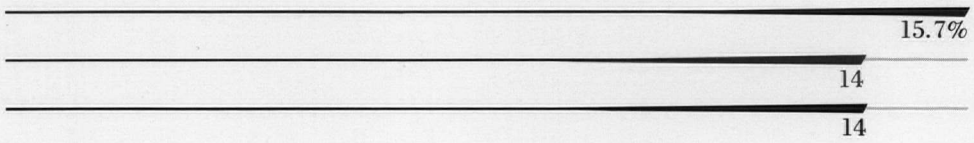
Five-Year Average

1980-1985

NSP

Electric Utility Industry

U.S. Industrials



NSP's five-year average return on equity of 15.7 percent tops the 14 percent return for both the electric utility industry and U.S. industry in general.

The prospect for dividend increases looks good. NSP in the second quarter of each of the past nine years has declared an increase in dividends. Over the past five years, dividend increases have averaged 8 percent per year, with an average payout ratio of 57 percent. Rapid earnings growth accounts for the relatively low ratio.

In 1985, dividends declared were 58 percent of earnings. Assuming the company achieves its earnings objectives, its plan is to increase the dividend payout ratio to 65 to 70 percent by 1988.

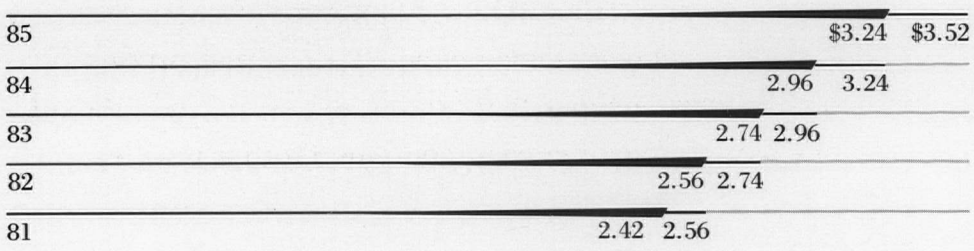
Yield does not always stack up as an accurate measure of a utility stock's investment potential. Even with a relatively low yield (dividends declared, divided by market price), NSP's stock remains a favorite of many analysts.

During the current bull market, an investment in a low-yield utility stock of high quality, like NSP's, often has done better than an investment in high-yield utility stocks. For example, assume an investor bought $100 of NSP stock and made a $100 investment spread equally among the six highest yielding utility stocks in July 1982, generally considered the beginning of the bull market.

Including dividends paid and sale of the stocks in December 1985, the investor was much better off with the NSP investment. The reason? NSP stock price went up faster and dividends increased at a higher percentage than those of the higher yielding companies. In that period, the investor gained $132 on the NSP stock purchase. An

Annualized Dividends

Dividends Increased to



NSP, electric utilities prepare to meet stiffer competition

investment in the higher yielding stocks saw an increase of only $44.

The electric utility industry in 1985 remained on an even keel financially, with no major improvements but no swampings either. In general, utilities retained gains made in 1983 and 1984 after several troubled years for the industry. Return on equity for the industry remained in the 14 percent range. Market price exceeded book value by about 15 percent.

The outlook for the electric utility industry is certainly full of challenges. Competition from alternate energy sources and suppliers will force utilities to improve service and better control costs. As seen with the telephone and natural gas industries, partial deregulation and advancing technology will enable non-utility energy suppliers and even other utilities to filter into the traditional service territory and marketplace monopolies.

The changing faces of regulation add to the challenge. In some cases, proposed regulations, such as acid rain legislation, would cost utilities and their customers hundreds of millions of dollars. On the other hand, federal deregulation of transmission lines might benefit low-cost energy suppliers and customers.

State regulators are shifting their focus from construction and financing of nuclear plants to rate treatment of those plants. Their decisions to allow or deny rate relief for these plants have a profound effect on a utility's bottom line, customers' bills and shareholders' return. Ultimately, these decisions can affect a utility's ability to compete and survive.

A recess in the construction cycle comes at a good time for the heavily debted industry. Utilities have the opportunity to build strong financial bases to prepare for the next round of construction and to compete in the changing energy supply market. Many utilities are using their new found cash flow to diversify into non-energy, unregulated ventures. Others, like NSP, are building on their experience as they expand their energy services.

The pace of change picks up each year. In this environment, quality management that is able to accept and take advantage of change becomes increasingly important for utilities.

Understanding customer needs is important service standard

Even with interim rate increases in effect for many customers, NSP's average retail price for electricity ranked among the lowest in the country. Over the past 20 years, the rise in NSP electric rates has remained below the rate of inflation. NSP's natural gas prices are at the national average.

Higher operating and maintenance expenses and completed major plant renovations led the company to request an annual electric rate increase of $121.7 million, or an average 12.68 percent, for Minnesota retail customers. NSP last filed such a case in July 1981. The Minnesota Public Utilities Commission (MPUC) approved an overall 9.29 percent interim rate increase effective Sept. 30, 1985. The MPUC will make its final decision by June 2, 1986.

The MPUC Jan. 29, 1986, voted to rescind its Dec. 30, 1985, order granting NSP an annual $17.1 million, 6.03 percent, rate increase for NSP's Minnesota natural gas customers.

NSP had asked the commission to redeliberate its December order because of the appearance of a conflict of interest when NSP discussed job openings with a retiring commissioner. The MPUC then dismissed the entire rate case and ordered NSP to refund interim rates collected since April 29, 1985.

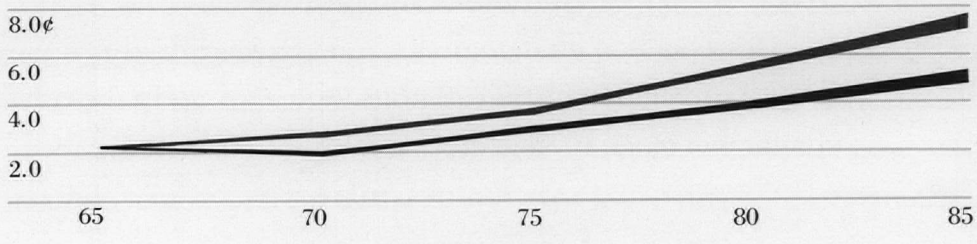
NSP has asked the MPUC to reconsider its January order and is seeking a stay of the order during the review process. NSP will appeal the dismissal of the December order if the MPUC does not reconsider the gas rate case and issue an order for redeliberation based on the recommendations previously made by an independent administrative law judge. NSP also plans to file a new gas rate case.

NSP filed requests with the Federal Energy Regulatory Commission (FERC) to increase wholesale electric rates by $5 million annually. Wholesale customers buy power from NSP for resale.

Retail Price per kwh

Consumer Price Index

NSP



Units 1 and 2 at the Prairie Island nuclear plant celebrated 10 years of operation with extensive inspection outages. Before its outage, unit 1 set a continuous operating record. The facility ranks with the most cost-effective power plants in the country.

1985 Rate Increase Program	Annual Increase			Effect on '85
Type	Requested (Millions)	Allowed (Millions)	Order Expected/Approved	Revenues (Millions)
Electric–Retail				
Minnesota	$121.7		6-2-86	$14.6
Wisconsin	11.1		3-11-86	
LSDP	1.0		3-11-86	
Electric–Wholesale				
Minnesota	2.9		7-1-86	
Wisconsin	1.4	$ 1.3	9-27-85	0.8
Wisconsin	.6		4-15-86	
Gas–Retail				
Minnesota	20.4	17.1	rescinded	6.9
Wisconsin	.2		5-15-86	
LSDP	.5		3-11-86	
Total	$159.8	$18.4		$22.3

NSP-Wisconsin and Lake Superior District Power (LSDP) also requested retail electric and gas rate increases.

NSP earned its 1985 revenues from wholesale and retail sales in these regulatory jurisdictions: 74 percent in Minnesota, 14 percent in Wisconsin, 6 percent in North Dakota, 3 percent in South Dakota, 1 percent in Michigan and 2 percent from wholesale transactions under FERC jurisdiction.

Retail electric sales increased 2.6 percent in 1985 over 1984 due mainly to a 1.8 percent increase in the average number of customers. Adjusted for weather, sales increased 3.1 percent.

Colder than normal weather and new space heating customers helped firm gas sales increase 4.2 percent. Weather-adjusted, they rose 3.2 percent.

Employee concern, awareness make year NSP's safest

Customers benefit from NSP's efforts to reduce their costs and optimize their energy use. Residential, commercial and industrial customers receive rebates, and monthly energy savings, by installing energy-efficient equipment and appliances. Energy audits are popular, using NSP's expertise to make homes and businesses more energy efficient.

Energy Sources for Electric Generation

Coal

Nuclear

Hydro & Other

Oil & Gas

About one-third of NSP's new residential customers heating with natural gas converted from other fuels. The company in 1986 will begin gas service to 2,113 homes on the U.S. Air Force base near Grand Forks, N.D. NSP continues to intervene in its gas supplier's rate cases to ensure the lowest possible prices.

NORENCO began providing energy services to two major food processing companies and has commitments for several cogeneration projects. One project calls for generating process steam by burning a mix of sawdust with coal and selling it to industrial and institutional customers.

Outstanding generating plant performance records are key factors to NSP's reliable, low-cost electricity.

A Utility Data Institute study listed NSP's Prairie Island nuclear plant as the fourth most cost-effective generating facility in the U.S. in 1984. The study ranked plants by combined fuel, operating and maintenance costs per megawatt-hour of generation. In 1983 Prairie Island was fifth; the Monticello nuclear plant ranked 15th. While nuclear plants dominated the top 100 list, NSP's coal-fired units also placed well.

Prairie Island units 1 and 2 celebrated a decade of service with maintenance outages required by the Nuclear Regulatory Commission. Unit 2 set a company nuclear plant record by operating continuously for 327 days before the required outage.

Plant availability is an important measure of good operations. NSP's largest coal-fired units, Sherco 1 and 2, were available for service 92 percent of the time in 1985; the industry average during 1980-1984 was 74 percent. NSP's nuclear plants combined in 1985 outperformed the industry five-year average by

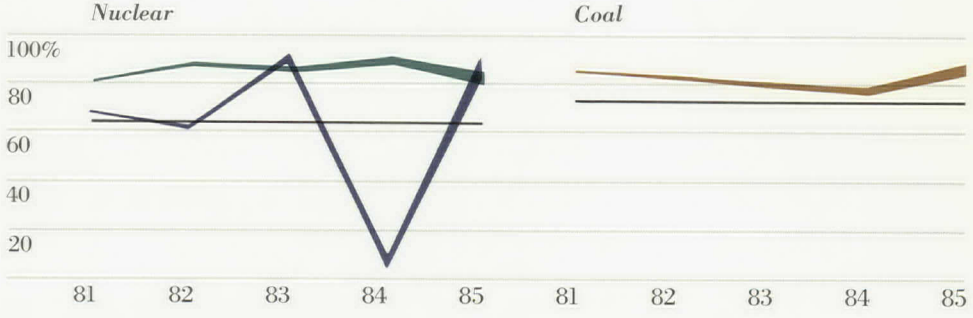
Plant Availability

Prairie Island units 1 & 2

Monticello

Sherco units 1 & 2 and Allen S. King

**National Average*



*North American Electric Reliability Council 1980-84 (400-799 Mw units)

Dedication to detail marks every facet of company's work

22 percentage points.

NSP maintained its excellent operations record while achieving another record: 1985 was one of the safest for employees. Employees of the Keystone division, south of the Twin Cities, worked 1 million hours–almost three years' worth–without a lost-time injury. Since 1980, the number of lost-workday injuries is down 79 percent.

Efficient, productive plants hold down both costs and rates. NSP's balance of coal, nuclear and hydro generation also keeps its electric prices competitive and is an important part of NSP's strategy to limit emissions from coal-fired plants while doubling total electric generation.

After 19 successful rail shipments of spent nuclear fuel from the Monticello plant to a General Electric (GE) storage facility in Illinois, NSP is taking a breather. The planned 30 total shipments (10 years' accumulation of spent fuel) will open temporary storage space at the plant. GE stores the spent fuel at no cost to NSP until 2003, when a federal disposal site should be open.

The U.S. Department of Energy presented NSP-Wisconsin and LSDP an "Award for Energy Innovation" for creative use of a waste product: burning waste wood to generate electricity. They became eligible for the national honor after winning a similar award from the State of Wisconsin.

NSP supports the communities it serves with research and personnel for economic development, comprehensive energy information for students and contributions to local community service groups. Other NSP-sponsored programs include energy-related workshops for the elderly and conservation and safety videotapes in several languages.

The company and the communities it serves benefit from the professionalism, expertise and dedication of NSP employees. Active and retired employees donate time to a variety of non-profit organizations. In 1985 employee contributions to the United Way increased 10 percent.

Northern States Power Company

Financial Statements

MANAGEMENT'S DISCUSSION & ANALYSIS

NSP's 1985 earnings per share were $5.93, up 13 cents from the $5.80 per share earned in 1984 and up 33 cents from the $5.60 earned in 1983. The earnings increase in 1985 came primarily from increased electric and gas sales and increased revenues due to electric and gas rate case filings in 1985.

Earnings subject to refund pending final rate case decisions are 23 cents per share for electric revenues and 11 cents per share for gas revenues. (See Note 3 to the financial statements.)

Electric Sales and Revenues

Total retail electric sales in 1985 increased 2.6 percent over 1984. Most of this increase resulted from a 1.8 percent increase in the average number of retail customers.

On a weather-adjusted basis, megawatt-hour sales to retail customers increased 3.1 percent in 1985, 5.2 percent in 1984 and 4.3 percent in 1983.

Electric revenues in 1985 increased a total of $13 million:

	1983/82	1984/83	1985/84
	(Millions of dollars)		
Sales Increases	$65	$34	$22
Rate Increases	6	4	15
Fuel Clauses & Other	36	39	(24)
Total	$107	$77	$13

Forecasted retail sales growth for 1986 is 3.6 percent, or 3.8 percent over 1985 weather-adjusted sales.

Gas Sales and Revenues

NSP categorizes gas sales as firm (primarily to heating customers) and interruptible (to customers with an alternate energy supply). Firm sales in 1985 increased 4.2 percent over 1984. This increase in firm sales was due to a 2.0 percent increase in the average number of firm customers and extremely cold weather in December 1985. On a weather-adjusted basis, firm sales increased 3.2 percent. Interruptible gas sales increased 3.7 percent in 1985 primarily because of increased demand.

NSP forecasts firm gas sales to decrease by 3.0 percent in 1986, or by 1.1 percent from 1985 weather-adjusted sales.

Electric Production Expense

Electric production expense, including fuel for electric generation and purchased and interchange power, decreased 9.2 percent in 1985, compared with increases of 17.4 percent in 1984 and 13.1 in 1983. The main reason for the 1985 decrease was reduced production costs per kilowatt-hour primarily as a result of more nuclear output in 1985 than in 1984. The Monticello nuclear plant had an extended outage in 1984.

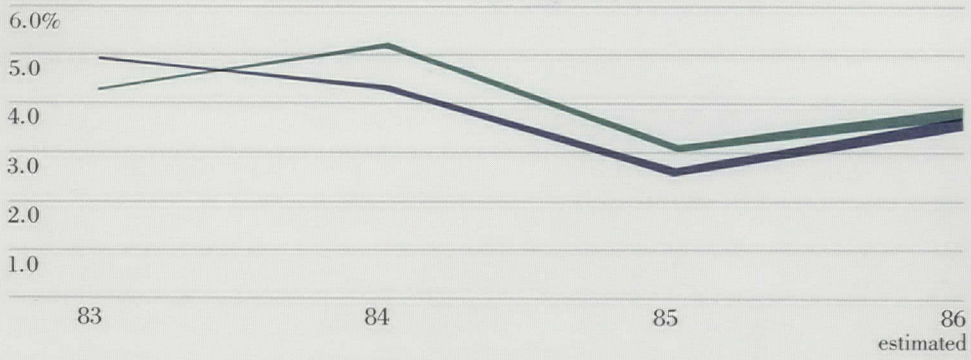
Gas Purchased for Resale

Gas purchased for resale decreased $3.6 million in 1985 due to lower unit prices from our supplier, Northern Natural Gas Company. Increased purchases to meet the needs of customers partially offset the cost decrease. NSP passes on any cost increases or decreases in purchased gas to its retail customers through a purchased gas adjustment clause.

Electric Retail Sales Growth

Actual

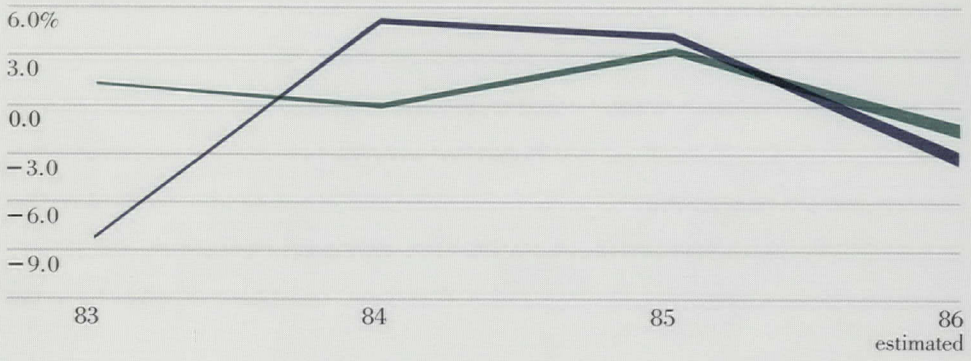
Weather-Adjusted



Firm Gas Sales Growth

Actual

Weather-Adjusted



Administrative and General, Other Operation and Maintenance

These expenses, in total, increased 8.0 percent in 1985 compared with increases of 12.9 percent in 1984 and 0.8 percent in 1983. The unusually small 1983 increase resulted primarily from less scheduled plant maintenance. The 1984 and 1985 increases are attributable to increased operating and maintenance activity at generating plants and increased labor costs.

Depreciation and Amortization

Depreciation and amortization increased $13.6 million, or 9.6 percent, during 1985. The increase was primarily due to increased nuclear plant investment resulting from replacement of recirculation pipes and condenser tubing at the Monticello nuclear plant in 1984.

Allowance for Funds Used During Construction (AFC)

AFC increased $7.5 million in 1985 and $14.2 million in 1984. The increases in both years were mainly due to continuing construction on Sherburne County Generating Unit No. 3 (Sherco 3).

Interest Expense

Interest expense increased by $9.4 million in 1985. This increase was the result of a full year's effect of tax-exempt bonds issued in 1984 and $144 million of long-term debt issued in 1985.

Effect of Inflation

See Note 13 to the financial statements for discussion of the effect of inflation on NSP.

Capital Resources

Internally generated funds provided 60 percent of the $514 million construction expenditures for 1985, and 88 percent of the $1.8 billion construction funds for 1981-1985.

NSP estimates construction expenditures will be $580 million in 1986, $2.4 billion for 1986-1990 and $3.8 billion for 1991-1995. NSP forecasts internally generated funds will provide 71 percent of 1986 construction expenditures, 82 percent for 1986-1990 and 66 percent of 1991-1995.

In addition to the construction program, NSP will need $109 million during the five-year period 1986-1990 to retire long-term debt and meet sinking fund requirements.

The Company has contracted with the U.S. Department of Energy (DOE) for the disposal of spent nuclear fuel. The DOE charges a fee for current electric generation that NSP pays quarterly. In 1985, NSP paid the DOE a one-time fee of $95 million for fuel used prior to April 7, 1983.

During 1985, the Company issued $144 million of long-term debt. In June, $100 million of first mortgage bonds, issued with a 30-year maturity, cost NSP 11.65 percent.

In September, the Company issued $14 million of first mortgage bonds as collateral for pollution control bonds that three municipalities issued to refund bonds that were issued in 1981. The redemption was effective Jan. 2, 1986. The new bond issues mature March 1, 2011. The bonds are variable rate demand purchase bonds that entitle bondholders to demand payment upon seven days' notice.

The Company also entered into a loan agreement with the County of Anoka, Minn., for the issuance of resource recovery revenue bonds totaling $30 million. These variable rate demand purchase bonds mature in installments from Dec. 1, 1989, through Dec. 1, 2008. NSP will use proceeds from this issue to construct a refuse derived fuel facility for Anoka County. The bond issue proceeds are available only for qualified expenditures as NSP constructs the facility.

At Dec. 31, 1985, trustees held a total of $134 million of funds from current and previous years' issues of pollution control and resource recovery bonds.

The Company in 1985 obtained $14 million from reinvested dividends under the Dividend Reinvestment and Stock Purchase Plan. The Company plans to use common stock purchased in the market for future years' reinvested dividends.

Tax benefit transfer leases, purchased in previous years under the Safe Harbor Lease provision of the Economic Recovery Tax Act of 1981, enabled NSP to defer $54 million of current income taxes in 1985. The Company expects to defer an additional $47 million in 1986. In the five-year period 1986-1990, NSP expects to defer a net of $7 million of current income taxes. At the end of 1986, the cumulative net cash flow from tax benefit transfer leases will peak at $162 million. Beginning in 1987, deferred taxes will begin to reverse, causing additional current income tax payments over the remaining lives of the leases.

Liquidity

Internal funds generation, access to long-term securities markets and the availability of long- and short-term credit line commitments provide liquidity.

At Dec. 31, 1985, 47.6 percent of NSP's total capital structure was debt, including short-term. NSP has strong interest coverage and favorable cash generation. Consequently, NSP expects to have access to long-term debt markets on better terms than the electric utility industry in general.

At Dec. 31, 1985, notes payable of $49 million represented about 2 percent of capitalization. Currently, NSP has $117 million of credit line commitments and $104 million of long-term revolving credit line commitments with commercial banks.

SELECTED FINANCIAL DATA

(Millions of dollars)	1985	1984	1983	1982	1981
Operating revenues	$1 788.7	$1 775.6	$1 695.8	$1 560.9	$1 280.9
Operating expenses	$1 540.1	$1 532.4	$1 443.4	$1 332.0	$1 082.9
Net income	$ 197.7	$ 192.1	$ 183.9	$ 157.7	$ 127.5
Earnings available for common stock	$ 184.7	$ 178.8	$ 170.3	$ 144.0	$ 114.0
Average shares of common stock outstanding (000s)	31 137	30 831	30 432	30 100	29 334
Earnings per share on average shares	$ 5.93	$ 5.80	$ 5.60	$ 4.79	$ 3.89
Dividends declared per share	$ 3.45	$ 3.17	$ 2.905	$ 2.695	$ 2.525
Total assets	$4 047.6	$3 741.7	$3 395.4	$3 196.9	$2 860.1
Long-term debt	$1 252.5	$1 142.5	$1 086.2	$1 004.0	$ 956.8
Mandatory redemption preferred stock (net of treasury shares)	$ 9.1	$ 9.1	$ 13.9	$ 15.1	$ 15.0
Ratio of earnings to fixed charges	4.7	5.0	4.9	4.4	4.0

FINANCIAL STATISTICS

Earnings per share on average shares	$ 5.93	$ 5.80	$ 5.60	$ 4.79	$ 3.89
Return on average common equity	15.6%	16.4%	17.1%	15.7%	13.5%
Dividends in percent of earnings	58.2%	54.7%	52.0%	56.4%	64.9%
Dividend in percent of book value	9.6%	9.5%	9.4%	9.3%	9.1%
Five year growth rates in earnings per share (1)	13.4%	13.3%	10.9%	8.7%	5.3%
Construction expenditures (millions)	$ 513.7	$ 401.0	$ 347.3	$ 291.0	$ 275.5
Percent of construction expenditures financed by internally generated funds (excluding AFC)	60.5%	100.0%	100.0%	61.7%	66.4%
Cash dividend coverage	4.4	4.8	5.7	4.9	3.8
AFC percent of earnings per share	22.6%	19.2%	11.8%	13.6%	13.3%
Effective tax rate	44.5%	44.8%	49.2%	49.1%	48.5%
Capitalization (2)					
Common	44.5%	45.1%	43.5%	40.5%	40.4%
Preferred	7.9%	8.6%	9.2%	9.5%	10.3%
Debt	47.6%	46.3%	47.3%	50.0%	49.3%
Total	100.0%	100.0%	100.0%	100.0%	100.0%
Embedded cost of long-term debt	8.08%	7.98%	7.96%	8.06%	7.76%
Average plant investment per dollar of revenue	$ 2.71	$ 2.50	$ 2.45	$ 2.47	$ 2.77
Depreciation reserve in percent of depreciable plant	33.9%	34.6%	34.1%	32.7%	30.2%
Depreciation provision in percent of average depreciable plant	3.63%	3.55%	3.47%	3.55%	3.47%
Benefit employees (at Dec. 31)	7 414	7 347	7 207	7 261	7 045

AFC - Allowance for Funds Used During Construction

(1) Least squares method.

(2) Includes notes payable and long-term debt and preferred stocks with mandatory redemption due within one year.

STATEMENT OF INCOME

(Thousands of dollars)	Year Ended December 31 1985	1984	1983
Operating Revenues			
Electric	$1 376 112	$1 362 620	$1 285 387
Gas	402 200	401 965	399 755
Telephone	10 430	11 024	10 671
Total	1 788 742	1 775 609	1 695 813
Operating Expenses			
Fuel for electric generation	256 989	245 934	249 637
Purchased and interchange power	94 059	140 522	79 626
Gas purchased for resale	300 375	303 985	313 315
Administrative and general	126 682	116 658	111 966
Other operation	189 698	171 332	156 547
Maintenance	139 697	134 110	105 338
Depreciation and amortization	155 664	142 017	136 581
Property and general taxes	124 387	123 588	116 888
Income taxes	152 530	154 239	173 517
Total	1 540 081	1 532 385	1 443 415
Operating Income	248 661	243 224	252 398
Other Income			
Allowance for funds used during construction–equity	32 841	27 047	13 187
Miscellaneous	11 769	5 818	7 758
Total	44 610	32 865	20 945
Total Income	293 271	276 089	273 343
Income Deductions and Non-Operating Taxes	7 602	3 741	4 358
Income Before Interest Charges	285 669	272 348	268 985
Interest Charges			
Interest on long-term debt	93 605	84 941	82 429
Other interest and amortization	3 283	2 557	9 601
Allowance for funds used during construction–debt	(8 944)	(7 253)	(6 947)
Total	87 944	80 245	85 083
Net Income	197 725	192 103	183 902
Preferred Stock Dividends	13 042	13 270	13 584
Earnings Available for Common Stock	$ 184 683	$ 178 833	$ 170 318
Average Shares of Common Stock Outstanding (000s)	31 137	30 831	30 432
Earnings per Share on Average Common Shares	$5.93	$5.80	$5.60
Common Dividends Declared per Share	$3.45	$3.17	$2.905

STATEMENT OF RETAINED EARNINGS

(Thousands of dollars)	Year Ended December 31 1985	1984	1983
Balance at Beginning of Year	$633 624	$552 619	$470 814
Net income	197 725	192 103	183 902
Income tax savings on dividends paid on ESOP shares	2 242		
Capital stock expense and other	(14)	1	(3)
Net additions	199 953	192 104	183 899
Dividends declared			
Cumulative preferred stock at required annual rates	13 042	13 270	13 584
Common stock–per share: 1985, $3.45; 1984, $3.17; 1983, $2.905	107 511	97 829	88 510
Total dividends declared	120 553	111 099	102 094
Balance at End of Year	$713 024	$633 624	$552 619

See Notes to Financial Statements on pages 32 to 39.

STATEMENT OF CHANGES IN FINANCIAL POSITION

(Thousands of dollars)	Year Ended December 31 1985	1984	1983
Source of Funds			
Funds from operations			
Net income	$197 725	$192 103	$183 902
Depreciation and other amortization	173 381	155 775	142 483
Nuclear fuel amortization	50 924	39 428	48 237
Deferred income taxes (including tax benefit transfers)	91 854	106 985	156 881
Investment tax credit adjustments–net	19 024	18 790	3 506
Allowance for funds used during construction	(41 785)	(34 300)	(20 134)
Total	491 123	478 781	514 875
Issuance of notes and securities			
Notes payable	24 029		
Long-term debt	143 515	61 376	200 102
Common stock	13 577	12 405	10 984
Total	181 121	73 781	211 086
Construction fund withdrawals	52 260	23 188	
Sale of Sherco 3 to co-owner		5 494	57 914
Total Source of Funds	$724 504	$581 244	$783 875
Application of Funds			
Construction expenditures	$513 719	$400 994	$347 326
Allowance for funds used during construction	(41 785)	(34 300)	(20 134)
Construction funds held by trustee	36 804	67 670	104 820
Repayment of notes payable		7 016	136 419
Retirement of long-term debt	33 156	5 051	22 671
Reclassification of nuclear fuel disposal cost		94 579	
Purchase of outstanding long-term debt			116 037
Acquisition of preferred stock with mandatory redemption		4 859	
Preferred and common dividends	120 553	111 099	102 094
Increase (decrease) in working capital (excluding notes payable)	57 658	(75 118)	(32 569)
Other–net	4 399	(606)	7 211
Total Application of Funds	$724 504	$581 244	$783 875
Increase (Decrease) in Working Capital (excluding notes payable)			
Cash and temporary cash investments	$ 3 210	$ (6 209)	$ 11 949
Accounts receivable–net	42 107	4 306	24 757
Federal income tax refund receivable	(10 000)	6 000	(21 000)
Materials and supplies	(5 888)	3 552	(11 514)
Long-term debt due within one year	(14 942)	20 000	(18 492)
Accounts payable, salaries, wages, etc.	(37 615)	(16 281)	(14 186)
Income and other taxes accrued	(10 913)	5 437	(10 334)
Nuclear fuel disposal cost payable	94 579	(94 579)	
Other current assets and liabilities–net	(2 880)	2 656	6 251
Total	$ 57 658	$ (75 118)	$ (32 569)

See Notes to Financial Statements on pages 32 to 39.

BALANCE SHEET

(Thousands of dollars)	December 31 1985	1984
Assets		
Utility Plant		
Electric–including construction work in progress: 1985, $528,233,000; 1984, $305,970,000	$4 197 039	$ 3 791 845
Gas	308 646	291 536
Other	148 139	138 979
Total	4 653 824	4 222 360
Accumulated provision for depreciation	(1 461 803)	(1 329 342)
Nuclear fuel–including in process: 1985, $66,109,000; 1984, $41,104,000	439 214	390 924
Accumulated provision for amortization	(288 658)	(237 735)
Net utility plant	3 342 577	3 046 207
Construction Funds	133 846	149 302
Other Property and Investments	117 993	118 225
Current Assets		
Cash	4 199	5 216
Temporary cash investments	8 078	3 851
Accounts receivable	213 094	171 100
Accumulated provision for uncollectible accounts	(2 415)	(2 528)
Federal income tax refund receivable	7 000	17 000
Materials and supplies–at average cost		
Fuel	78 253	88 499
Other	51 630	47 272
Prepayments and other	30 325	28 721
Total current assets	390 164	359 131
Deferred Debits		
Extraordinary property losses	12 499	19 361
Other	50 550	49 504
Total deferred debits	63 049	68 865
Total	$4 047 629	$3 741 730

See Notes to Financial Statements on pages 32 to 39.

(Thousands of dollars)	December 31 1985	1984
Liabilities		
Capitalization (Pages 30 & 31)		
Common stock–authorized 40,000,000 shares of $5 par value; issued shares: 1985, 32,040,418; 1984, 31,744,296	$ 160 202	$ 158 721
Premium on common stock	379 025	366 929
Retained earnings	713 024	633 624
Treasury stock–shares at cost: 1985 and 1984, 769,716	(19 194)	(19 194)
Total common stock equity	1 233 057	1 140 080
Cumulative preferred stock–authorized 3,545,000 shares of $100 par value; outstanding shares: 1985 and 1984, 2,171,417		
Without mandatory redemption	208 000	208 000
With mandatory redemption (net of treasury shares at cost)	9 069	9 097
Premium on preferred stock	703	674
Long-term debt	1 252 539	1 142 512
Total capitalization	2 703 368	2 500 363
Current Liabilities		
Notes payable	49 129	25 100
Long-term debt due within one year	15 722	780
Accounts payable	180 348	145 043
Nuclear fuel disposal cost payable		94 579
Salaries, wages, and vacation pay accrued	20 627	18 317
Federal income taxes accrued	3 439	2 281
Other taxes accrued	100 457	90 702
Interest accrued	21 940	20 727
Dividends declared on preferred and common stocks	30 741	28 323
Other	1 403	550
Total current liabilities	423 806	426 402
Deferred Credits		
Accumulated deferred income taxes	663 706	576 856
Accumulated deferred investment tax credits	241 389	222 365
Other	15 360	15 744
Total deferred credits	920 455	814 965
Total	$4 047 629	$3 741 730

See Notes to Financial Statements on pages 32 to 39.

STATEMENT OF CAPITALIZATION

(Thousands of dollars)				December 31 1985	1984
Common Stock Equity					
Common stock–authorized 40,000,000 shares of $5 par value; issued shares: 1985, 32,040,418; 1984, 31,744,296				$ 160 202	$ 158 721
Premium on common stock				379 025	366 929
Retained earnings				713 024	633 624
Treasury stock–shares at cost: 1985 and 1984, 769,716				(19 194)	(19 194)
Total common stock equity				1 233 057	1 140 080
Cumulative Preferred Stock					
Without mandatory redemption					
Minnesota Company					
$3.60 series, 275,000 shares	$ 27 500				
4.08 series, 150,000 shares	15 000				
4.10 series, 175,000 shares	17 500				
4.11 series, 200,000 shares	20 000				
4.16 series, 100,000 shares	10 000				
4.56 series, 150,000 shares	15 000				
6.80 series, 200,000 shares	20 000				
7.00 series, 200,000 shares	20 000				
8.80 series, 250,000 shares	25 000				
7.84 series, 350,000 shares	35 000				
Total	205 000			205 000	205 000
Lake Superior District Power Company					
$5.00 series, 30,000 shares	3 000			3 000	3 000
Total without mandatory redemption	$208 000			208 000	208 000
With mandatory redemption					
Minnesota Company		1985	1984		
$10.36 series, 1985, 137,500 shares; 1984, 150,000 shares		$13 750	$15 000		
Less treasury stock at cost (1985, 46,092 shares; 1984, 58,583 shares)		4 681	5 903		
Net with mandatory redemption		$ 9 069	$ 9 097	9 069	9 097
Premium on preferred stock				703	674
Long-Term Debt					
First Mortgage Bonds Minnesota Company					
Series due:					
Sept. 1, 1986, 4¼%	$15 000	June 1, 2001, 8¼%	50 000		
July 1, 1988, 4%	30 000	July 1, 2001, 11%	13 745*		
Dec. 1, 1990, 5%	35 000	Mar. 1, 2002, 7⅜%	50 000		
Aug. 1, 1991, 4⅞%	20 000	Feb. 1, 2003, 7½%	50 000		
June 1, 1992, 4⅜%	15 000	Jan. 1, 2004, 8⅜%	75 000		
Sept. 1, 1993, 4⅜%	15 000	Oct. 1, 1989-2004, 7.98%	35 000*		
June 1, 1995, 6⅛%	30 000	May 1, 1996-2005, 7⅝%	25 000*		
Mar. 1, 1996, 6.2%	8 800*	May 1, 2005, 9½%	80 000		
Aug. 1, 1996, 5⅞%	45 000	Dec. 1, 2011, 15¾%	7 899		
Oct. 1, 1997, 6½%	30 000	May 1, 2013, 10⅞%	75 000		
May 1, 1998, 6¾%	45 000	Dec. 1, 2013, 10⅜%	100 000*		
Oct. 1, 1999, 8%	45 000	Oct. 1, 2014, Variable Rate	32 500*		
Mar. 1, 2001, 8%	50 000	Dec. 1, 1989-2006, Variable Rate	27 700**		
		Total	1 005 644		1 005 644
		June 1, 2015, 11½%	100 000		
		Mar. 1, 2011, Variable Rate	13 700*		
		Less current maturities	15 000		
		Less redemption of July 1, 2001, 11% series	13 745*		
		Less amounts reacquired Dec. 1, 2011, 15¾% series	750		
		Net	$1 089 849	1 089 849	

*Pollution control financing. **Resource recovery financing. See Notes to Financial Statements on pages 32 to 39.

(Thousands of dollars)				December 31 1985	1984
Long-Term Debt–continued					
First Mortgage Bonds Wisconsin Company–(less reacquired bonds of $747,000 and $1,250,000 at Dec. 31, 1985 and 1984, respectively)					
Series due:	Annual Sinking Fund Requirement	1985	1984		
June 1, 1987, 4⅝%	$100	$ 7 246	$ 7 246		
Aug. 1, 1994, 4½%	150	11 653	11 653		
Feb. 1, 1997, 13¾%	16	1 600*	1 600*		
Dec. 1, 1999, 9¼%	100	8 400	8 423		
Oct. 1, 2003, 7¾%	300	26 454	26 578		
Mar. 1, 2012, 16%	300	97	397		
Total	$966	55 450	55 897		
Less current sinking fund requirements not reacquired		197	300		
Net		$55 253	$55 597	55 253	55 597
First Mortgage Bonds Lake Superior District Power Company–(less reacquired bonds of $276,000 and $186,000 at Dec. 31, 1985 and 1984, respectively)					
Series due:	Annual Sinking Fund Requirement				
Feb. 1, 1991, 4⅝%	$ 30	$ 1 943	$ 2 093		
Oct. 1, 1995, 10¾%	260	3 900	4 160		
June 1, 1997, 8.55%	160	3 040	3 200		
Aug. 1, 1998, 7⅛%	30	3 000	3 000		
Sept. 1, 2003, 8%	60	2 400	2 460		
Total	$540	14 283	14 913		
Less current sinking fund requirements not reacquired		480	480		
Net		$13 803	$14 433	13 803	14 433
Guaranty Agreements Minnesota Company					
Series due:*					
Feb. 1989-2003, 5.40%		$ 7 600	$ 7 600		
May 1, 1987-2003, 5.67%		28 750	28 750		
Feb. 1, 2003, 7.40%		3 500	3 500		
Total		$39 850	$39 850	39 850	39 850
NORENCO–Long-term Bank Loans, Variable Rate		$10 333	$12 333	10 333	12 333
Miscellaneous Long-Term Debt					
Anoka County Resource Recovery Bond–Series due Dec. 1, 1989-2008, Variable Rate		$29 750**			
Sioux Falls Ind. Development Bond–Series due 1976-1998, 5.72%		665	$ 700		
Inver Grove Hgts. Ind. Dev. Bond–Series due Feb. 11, 1995, 7.125%		1 000	1 000		
Red Wing Ind. Development Bond–Series due July 1, 2007, 13%		1 000	1 000		
Becker Pollution Control Bond–Series due Dec. 1, 2005, 9.7%		9 000*	9 000*		
Other		3 076	3 663		
Total		$44 491	$15 363	44 491	15 363
Unamortized Premium (Discount) on Long-Term Debt–Net				(1 040)	(708)
Total Long-Term Debt				1 252 539	1 142 512
Total Capitalization				$2 703 368	$2 500 363

*Pollution control financing. **Resource recovery financing. See Notes to Financial Statements on pages 32 to 39.

NOTES TO FINANCIAL STATEMENTS

1. Summary of Accounting Policies

System of Accounts

The accounting records of the Company, the Wisconsin Company and Lake Superior District Power Company (LSDP) are maintained in accordance with either the uniform system of accounts prescribed by the Federal Energy Regulatory Commission (FERC) or those prescribed by state regulatory commissions, which systems are the same in all material respects.

Principles of Consolidation

All significant subsidiary companies have been included in the consolidated financial statements.

Utility Plant and Retirements

Utility plant is stated at original cost. The cost of additions to utility plant includes contracted work, direct labor and materials, allocable overhead and allowance for funds used during construction. The cost of units of property retired, plus net removal cost, is charged to accumulated provision for depreciation and amortization. Maintenance and replacement of items determined to be less than units of property are charged to operating expenses.

Allowance for Funds Used During Construction (AFC)

AFC, a non-cash item, is computed by applying a composite rate, representing the cost of capital for construction, to qualified Construction Work in Progress (CWIP) and to the balance of qualified construction fund proceeds on deposit with trustees. The AFC rate was 9% in 1985 and 1984 and 8% in 1983. Because of rate treatment in Minnesota, the net of tax AFC rate used approximates the rate that would be obtained if a gross rate were used and the income tax effect were recorded as deferred taxes. AFC is included in net income and CWIP. The AFC included in CWIP is included in utility rate base for establishing utility service rates.

Construction Funds

Construction funds from pollution control and resource recovery financings are not available to the Company until approved expenditures have been made on the applicable facilities. Until the funds are available to the Company, they are invested by a trustee. Because AFC is calculated on the utility property trust fund balance during the period of construction, the associated earnings are credited to CWIP.

Depreciation

For financial reporting purposes, depreciation is computed by applying the straight-line method to the estimated useful lives of various classes of property. Depreciation provisions, as a percentage of the average balance of depreciable property in service, were 3.63% in 1985, 3.55% in 1984 and 3.47% in 1983. The provision for decommissioning costs for the nuclear plants has been calculated by using an internal sinking-fund method that is designed to provide for full recovery of the costs.

Nuclear Fuel Expense

The original cost of the fuel is amortized to fuel expense based on the energy expended. Nuclear fuel expense also includes estimated disposal costs of 0.1¢ per kilowatt-hour of nuclear generation, as required by the Nuclear Waste Policy Act of 1982. Expenses were $12.0 million, $8.8 million and $9.0 million for 1985, 1984 and 1983 respectively.

Income Taxes

Income taxes now are deferred for substantially all book and tax timing differences. However, income tax expense is affected by the reversal of amounts previously accounted for by the flow-through method.

Investment Tax Credits

Investment tax credits are deferred and amortized over the estimated lives of the related property. Additional investment tax credits based on 0.5% of the compensation of employees covered by the Employee Stock Ownership Plan (ESOP) did not affect net income because a charge to investment tax credit adjustment offset the reduction in federal income tax charged to operations.

Revenues

Customers' meters are read and bills are rendered on a cycle basis. Revenues of the Company are recorded in the accounting period during which the meters are read. The Wisconsin Company and LSDP, pursuant to an order of the Public Service Commission of

Wisconsin, accrue estimated unbilled revenues for services provided from the monthly meter-reading date to month-end. The Companies' rate schedules, applicable to substantially all customers, include cost of energy-adjustment clauses under which the rates are adjusted to reflect changes in average costs of fuels, purchased power and gas purchased for resale.

Purchased Tax Benefits

The Company and the Wisconsin Company purchased tax-benefit transfer leases under the Safe Harbor Lease provisions of the Economic Recovery Tax Act of 1981. The Companies are amortizing the difference between the cost of the purchased tax benefits and the amounts to be realized through reduced current income tax liabilities over the remaining terms of the leases after the initial investments have been recovered.

2. Income Tax Expense

The total income tax expense differs from the amount computed by applying the federal income tax statutory rate (46%) to net income before income tax expense. The reasons for the difference are as follows:

(Thousands of dollars)	1985	1984	1983
Tax computed at statutory rate	$164 000	$160 134	$166 684
Increases (decreases) in tax from:			
State income taxes net of federal income tax benefit	19 170	17 267	22 286
Allowance for funds used during construction (AFC)	(19 221)	(15 778)	(9 262)
AFC included in book depreciation	3 733	3 326	3 468
Investment tax credit on plant additions	(37 101)	(32 180)	(22 765)
Investment tax credit adjustments–net	25 033	21 173	12 855
Reduced tax depreciation resulting from use of the flow-through method in prior years*	6 054	6 381	6 210
Other–net	(2 871)	(4 309)	(1 021)
Total income tax expense	$158 797	$156 014	$178 455
Effective income tax rate	44.5%	44.8%	49.2%
Composite statutory tax rate	52.0%	52.2%	52.0%
Income tax expense is comprised of the following:			
Included in income taxes:			
Current federal tax expense	$ 64 803	$ 60 720	$ 55 093
Current state tax expense	30 133	25 366	23 083
Deferred federal tax expense	28 174	40 408	68 656
Deferred state tax expense	4 023	6 318	17 536
Investment tax credit adjustments–net	25 397	21 427	9 149
Total	152 530	154 239	173 517
Included in depreciation expense:			
Deferred federal tax expense	3 081	2 199	4 359
Deferred state tax expense	480	380	696
Included in income deductions:			
Current federal tax expense**	(46 232)	(50 370)	(58 193)
Current state tax expense	(6 055)	(7 339)	(8 353)
Deferred federal tax expense	48 438	49 909	54 415
Deferred state tax expense	6 919	7 250	8 308
Investment tax credit adjustments–net	(364)	(254)	3 706
Total income tax expense	$158 797	$156 014	$178 455
Deferred income tax expense is comprised of the following:			
Nuclear fuel disposal costs	$ (1 121)	$ (1 021)	$ 45 982
Excess of tax over book depreciation–net	31 289	36 095	24 332
Tax benefit transfer leases	53 227	55 559	59 639
ADR repair allowance	3 173	15 210	10 089
Overhead costs	7 687	7 937	5 348
Premium on bond purchase	(385)	(494)	11 138
Other	(2 755)	(6 822)	(2 558)
Total	$ 91 115	$106 464	$153 970

*At Dec. 31, 1985 and 1984 the Company had $24 million and $35 million, respectively, of cumulative income tax timing differences for which no deferred income taxes have been provided.

**Tax-benefit transfer leases reduced current federal income tax expense in 1985, 1984 and 1983 by $47 million, $49 million and $52 million, respectively.

3. Revenues Subject to Refund

Electric revenues for the quarter and year ended Dec. 31, 1985, include $14,600,000 that is subject to refund pending the outcome of a rate increase request. These revenues increased net income by $7,000,000 (23¢ per share).

On Jan. 29, 1986, the Minnesota Public Utilities Commission (MPUC) voted to reverse its ruling of Dec. 30, 1985, approving an annual gas rate increase of $17,100,000. The MPUC ordered the case dismissed and ordered NSP to return to customers interim revenues collected. NSP has asked the MPUC to reconsider its January order. Gas revenues for the year ended Dec. 31, 1985, include $6,900,000 that is subject to refund pending the outcome of the appeal of the decision. These revenues increased net income for the year ended Dec. 31, 1985, by $3,300,000 (11¢ per share).

4. Common Stock

	Common Stock			Treasury Stock	
(Thousands of dollars)	Shares	Par Value	Premium	Shares	Cost
Balance at January 1, 1983	31 115 580	$155 578	$346 683	878 090	$(21 804)
Dividend Reinvestment and Stock Purchase Plan	308 058	1 540	8 632		
Issuance of Treasury Stock for property acquisitions			812	(98 323)	2 462
Balance at December 31, 1983	31 423 638	157 118	356 127	779 767	(19 342)
Dividend Reinvestment and Stock Purchase Plan	320 658	1 603	10 604		
Issuance of Treasury Stock for property acquisitions			198	(17 975)	450
Purchase of stock through small lot tender offer				7 924	(302)
Balance at December 31, 1984	31 744 296	158 721	366 929	769 716	(19 194)
Dividend Reinvestment and Stock Purchase Plan	296 122	1 481	12 096		
Balance at December 31, 1985	32 040 418	$160 202	$379 025	769 716	$(19 194)

The Company's Articles of Incorporation and First Mortgage Bond Trust Indenture provide for certain restrictions on the payment of cash dividends on common stock. At Dec. 31, 1985, the payment of cash dividends on common stock was not restricted.

5. Cumulative Preferred Stock

All Issues

At Dec. 31, 1985, the various preferred stock series may be called at prices per share ranging from $102.00 to $105.55, plus accrued dividends.

Mandatory Redemption Issue

The $10.36 series is subject to a mandatory annual sinking-fund requirement to retire a minimum of 12,500 shares, but not more than 25,000 shares, at the original purchase price of $101.10 per share plus accrued dividends.

6. Long-Term Debt

The annual sinking-fund requirements of the Company's First Mortgage Indenture are the amounts necessary to redeem 1% of the highest principal amount of each series of first mortgage bonds at any time outstanding, but excluding those series issued for pollution control and resource recovery financings. Property additions have been applied in lieu of cash, as permitted by the Company's First Mortgage Indenture, except for cash redemptions for the 15¾% Series due Dec. 1, 2011.

The annual sinking-fund requirements of the Wisconsin Company and LSDP First Mortgage Indentures are the amounts necessary to redeem from 1% to 4% of the highest principal amount of each series of first mortgage bonds at any time outstanding.

Except for minor exclusions, all utility property is subject to the liens of the first mortgage bond trust indentures.

The variable rate First Mortgage Bonds Series due Oct. 1, 2014, Dec. 1, 1989-2006, March 1, 2011, and the variable rate Anoka County Resource Recovery Bond Series due Dec. 1, 1989-2008 are redeemable at the option of the holder of the bonds upon seven days' notice. These variable rate bonds are supported by $104,000,000 of long-term credit facilities that expire in 1991.

Maturities and sinking-fund requirements on long-term debt are as follows: 1986, $15,722,000; 1987, $10,580,000; 1988, $33,483,000; 1989, $9,130,000; and 1990, $40,304,000.

7. Short-Term Borrowings and Compensating Balances

Exclusive of the long-term credit facilities listed in Note 6 , there are currently bank lines of credit aggregating $117 million. These lines involve differing compensating balance and/or commitment fee arrangements. Substantially all cash is considered compensating balances. However, there were no withdrawal restrictions on any collected balances maintained at these banks. These credit lines make short-term financing available by providing bank loans and support for commercial paper.

8. Pension Plans and Other Post Retirement Benefits

Noncontributory defined benefit pension plans cover substantially all employees. Pension costs are determined under the aggregate-cost method, using market value of assets of the trust fund. Contributions, equal to the pension costs accrued, made to the trust fund were $27,633,000 for 1985, $28,520,370 for 1984 and $27,739,600 for 1983. For the year 1985, certain actuarial assumptions were changed, principally the assumed rate of investment return. The return on investment was increased from 7% for 1984 to 8% for 1985. This reduced the 1985 contribution by $8 million as compared with 1984. Other actuarial assumption changes and amendments to the plan in 1985 increased the contribution by $6 million compared with 1984. These changes increased net income by $1 million (3¢ per share). The weighted-average assumed rate of return used in determining the actuarial present value of accumulated plan benefits was 8% for 1985 and 7% for 1984. A comparison of accumulated plan benefits and plan net assets for the plans follows.

	December 31	
(Thousands of dollars)	1985	1984
Actuarial present value of accumulated plan benefits:		
Vested	$376 712	$364 763
Nonvested	30 963	17 053
Total	$407 675	$381 816
Net assets available for benefits	$545 239	$425 398

In addition to providing pension benefits, health care and death benefits are provided for retired employees. Substantially all employees become eligible for these benefits upon reaching retirement age. The costs of these benefits are recognized as an expense when paid. For 1985 and 1984, costs attributable to retired employees were $4,174,000 and $3,499,000 for medical benefits and $269,000 and $180,000 for death benefits respectively.

9. Joint Plant Ownership

The Company is a participant in a jointly owned project for the construction of an 800-megawatt coal-fired electric generating unit called Sherburne County Generating Station Unit No. 3 (Sherco 3), scheduled for commercial operation during late 1987. Undivided interests in Sherco 3 are owned by the Company (59%) and Southern Minnesota Municipal Power Agency (Southern Minnesota) (41%). Each participant in Sherco 3 provides its own financing. The Company is the construction and operating agent under an agreement with Southern Minnesota. At Dec. 31, 1985 and 1984, the Company's share of the cost was $313,662,000 and $166,651,000 respectively, which is recorded in CWIP.

10. Commitments and Contingent Liabilities

The Company presently estimates construction expenditures will be $580 million in 1986 and $2.4 billion for 1986-90. There also are contracts for the disposal of spent nuclear fuel and for the purchase and delivery of coal and natural gas.

Rentals under operating leases were approximately $10,691,000, $11,773,000 and $15,230,000 for 1985, 1984 and 1983, respectively.

The Company has signed a memorandum of understanding with Minnesota Power to purchase a 207-megawatt (MW) share of Minnesota Power's 517-MW Clay Boswell Unit 4 Generating Station. The Company will also purchase an additional 102 MW for a period of 17 years from a Minnesota Power source in North Dakota (Square Butte). The proposed agreement would require the Company to purchase power in increments of 69 MW of the

Clay Boswell unit and 34 MW of Minnesota Power's energy contract with Square Butte each year beginning May 1, 1989, through May 1, 1991. The total purchase price of the proposed Clay Boswell Unit is approximately $182 million. The Company will pay capacity charges, fuel, operation and maintenance charges for the Square Butte power.

The Company has an agreement with the Manitoba Hydro-Electric Board that expires in 1992. The agreement provides for 300 MW of capacity which is 5% of the Company's total system capability. The Company has another agreement with the Manitoba Hydro-Electric Board to purchase an additional 200 MW through 1988 at a minimum annual cost of $2,400,000. This agreement can be extended annually through 1992.

The Company has negotiated an additional contract with the Manitoba Hydro-Electric Board to provide the Company with 500 MW of capacity and 3,285,000 megawatt-hours of energy annually for the period 1993 through 2004. The Company's obligation under the contract, beginning in 1993, is based upon 80% of the Company's cost of owning and operating Sherco 3.

The Price-Anderson liability provisions of the Atomic Energy Act of 1954 set a limit of $635 million for public liability claims that could arise from a nuclear incident. The Company purchases the maximum available private insurance of $160 million to satisfy such claims. Claims from $160 million to the $635 million limit would be satisfied by a Nuclear Regulatory Commission (NRC) assessment against all owners of licensed nuclear generating units. In the event of such an assessment by the NRC, the Company could be charged up to $5 million for each of its three licensed nuclear reactors, subject to a maximum assessment of $10 million per reactor for any one year.

11. Segment Information

(Thousands of dollars)	Year Ended December 31 1985	1984	1983
Operating revenues			
Electric	$1 376 112	$1 362 620	$1 285 387
Gas	402 200	401 965	399 755
Other	10 430	11 024	10 671
Total operating revenues	$1 788 742	$1 775 609	$1 695 813
Operating income before income taxes			
Electric	$ 367 913	$ 364 318	$ 399 757
Gas	29 955	29 606	22 552
Other	3 323	3 539	3 606
Total operating income before income taxes	$ 401 191	$ 397 463	$ 425 915
Depreciation and amortization			
Electric	$ 142 431	$ 128 483	$ 123 609
Gas	11 289	10 748	10 262
Other	1 944	2 786	2 710
Total depreciation and amortization	$ 155 664	$ 142 017	$ 136 581
Construction expenditures			
Electric	$ 480 427	$ 376 883	$ 290 434
Gas	22 636	17 442	10 263
Other	10 656	6 669	46 629
Total construction expenditures	$ 513 719	$ 400 994	$ 347 326
Net utility plant			
Electric	$3 119 902	$2 833 959	$2 531 185
Gas	207 028	197 923	192 892
Other	15 647	14 325	16 497
Total net utility plant	3 342 577	3 046 207	2 740 574
Other corporate assets	705 052	695 523	654 811
Total assets	$4 047 629	$3 741 730	$3 395 385

12. Summarized Quarterly Financial Data (Unaudited)

(Thousands of dollars)	Quarter Ended March 31, 1985	June 30, 1985	September 30, 1985	December 31, 1985
Operating revenues	$546 152	$386 886	$389 872	$465 832
Operating income	77 572	51 756	62 731	56 602
Net income	65 750	39 534	49 053	43 388
Earnings available for common stock	62 490	36 273	45 792	40 128
Earnings per common share	$2.01	$1.17	$1.47	$1.28
Dividends declared per common share	$ .81	$ .88	$ .88	$ .88

(Thousands of dollars)	Quarter Ended March 31, 1984	June 30, 1984	September 30, 1984	December 31, 1984
Operating revenues	$524 980	$393 266	$413 296	$444 067
Operating income	79 662	54 766	61 914	46 882
Net income	66 183	43 096	51 667	31 157
Earnings available for common stock	62 799	39 753	48 324	27 957
Earnings per common share	$2.05	$1.29	$1.56	$ .90
Dividends declared per common share	$ .74	$ .81	$ .81	$ .81

13. Financial Reporting of Changing Prices (Unaudited)

The following information is supplied in accordance with the requirements of the Financial Accounting Standards Board (FASB) Statement No. 33, Financial Reporting and Changing Prices, as amended by FASB No. 82, for the purpose of providing certain information about the effects of changing prices. This information is not intended as a substitute for earnings reported on a historical cost basis. It offers some perspective on the approximate effects of inflation rather than a precise measurement of these effects.

Property, Plant and Equipment

The current cost of all depreciable property is the estimated cost of replacing existing depreciable property. It was determined by indexing the original cost of the property by the Handy-Whitman Index of Public Utility Construction Costs. The unrecovered portion of the original cost of the capitalized nuclear fuel is restated in terms of current cost by applying the Consumer Price Index for All Urban Consumers. Spent nuclear fuel is not reflected in either of the supplementary calculations.

Accumulated Depreciation

The net assets at year-end were determined by reducing the property, as adjusted by current costs, by the corresponding theoretical accumulated provision for depreciation. This provision for accumulated depreciation was calculated by applying the appropriate survivor-curve reserve ratios, by FERC account, to the respective vintaged indexed amounts.

Depreciation Expense

The current year's provision for depreciation was determined by applying depreciation rates, by FERC account, to the year's average indexed plant amounts.

Increase to Net Recoverable Cost

Under the rate-making prescribed by the regulatory commissions, only the historical cost of plant is recoverable in revenues as depreciation. Therefore, the excess of the cost of plant, stated in terms of current cost, over the historical cost of plant is not presently recoverable in rates as depreciation and is reflected as an increase to net recoverable cost. While the rate-making process gives no recognition to the current cost of property, management believes it will be allowed to earn on the increased cost of its net investment when replacement of facilities actually occurs.

Gain from Decline in Purchasing Power of Net Amounts Owed

By holding monetary assets, a loss of purchasing power is suffered during periods of inflation because the amount of cash received in the future for these items will purchase less. Conversely, by holding monetary liabilities, primarily long-term debt, there is a benefit because the payment in the future will be made with dollars having less purchasing power. Significant amounts of long-term debt are outstanding that will be paid back in dollars having less purchasing power and, therefore, for purposes of these calculations, a net gain is shown from holding monetary liabilities in excess of monetary assets. However, the Company, the Wisconsin Company and LSDP do not have the

opportunity to realize a holding gain on debt and preferred stock because they are limited to the recovery of only the historical embedded cost.

Other Items

Fuel inventories, the cost of fuel used in generation and gas purchased for resale have not been restated. Regulation permits the recovery of actual fuel and purchased gas costs through the operation of adjustment clauses in basic rate schedules. For this reason, fuel inventories are effectively monetary assets.

Since present tax laws do not allow deductions for higher depreciation rates to reflect the effects of inflation, income taxes included in the data adjusted for general inflation were not adjusted from those amounts presented in the primary financial statements. Therefore, the Company's effective federal income tax rate, when adjusted for inflation, is 86.9% under current cost for 1985, which exceeds the Company's reported effective tax rate of 44.5%.

Statement of Income from Continuing Operations Adjusted for Changing Prices (Thousands of dollars)	For the Year Ended December 31, 1985 Historical Cost	Current Cost Average 1985 Dollars
Operating revenues	$1 788 742	$1 788 742
Electric fuel and purchased power	351 048	351 048
Gas purchased for resale expense	300 375	300 375
Depreciation	148 831	322 588
Amortization	6 833	6 833
Other operating and maintenance expense	580 464	580 464
Income tax expense	152 530	152 530
Interest charges	87 944	87 944
Other income and deductions–net	(37 008)	(37 008)
Total	1 591 017	1 764 774
Income from continuing operations (excluding reduction to net recoverable cost)*	$ 197 725	$ 23 968
Increase to net recoverable cost		$ 71 990
Gain from decline in purchasing power of net amounts owed		$ 73 944
Effect of increase in general price level		$ 223 565
Increase in specific prices (current cost) of property held during the year**		207 609
Excess of increase in general price level over increase in specific prices		$ 15 956

*Including the increase to net recoverable cost, the income from continuing operations on a current cost basis would have been $95,958.

**At Dec. 31, 1985, current cost of property, net of accumulated depreciation was $6,212,764, while historical cost or net cost recoverable through depreciation was $3,342,577.

Five-Year Comparison of Selected Supplementary Financial Data Adjusted for Effects of Changing Prices (In Thousands of Mid-Year 1985 dollars)	Years Ended December 31 1985	1984	1983	1982	1981
Operating revenues					
As reported	$1 788 742	$1 775 609	$1 695 813	$1 560 916	$1 280 889
Adjusted	1 788 742	1 841 307	1 833 174	1 731 056	1 521 696
Income (Loss) from continuing operations (excluding reduction to net recoverable cost)					
As reported	$ 197 725	$ 192 103	$ 183 902	$ 157 693	$ 127 553
Current cost adjusted	23 968	21 172	25 416	1 929	(7 226)
Income (Loss) per common share (after dividend requirements on preferred stock)					
As reported	$5.93	$5.80	$5.60	$4.79	$3.89
Current cost adjusted	.35	.24	.35	(.36)	(.64)

Five-Year Comparison—cont.	Years Ended December 31				
(In Thousands of Mid-Year 1985 dollars)	1985	1984	1983	1982	1981
Net assets at year-end at net recoverable cost					
As reported	$1 450 829	$1 357 851	$1 269 152	$1 175 024	$1 085 581
Current cost adjusted	1 428 229	1 407 409	1 346 987	1 294 670	1 242 273
Excess of increase in general price level over increase in specific prices	$ 15 956	$ 51 669	$ (86 054)	$ (266 236)	$ (112 941)
Gain from decline in purchasing power of net amounts owed	$ 73 944	$ 71 748	$ 68 983	$ 70 994	$ 164 067
Cash dividends declared per common share					
As reported	$3.45	$3.170	$2.905	$2.695	$2.525
Adjusted	3.45	3.287	3.139	2.988	2.993
Market price per common share at year-end					
As reported	$53.0	$41.75	$38.0	$30.0	$24.125
Adjusted	53.0	43.29	41.07	33.26	28.64
Mid-Year consumer price index	322.3	310.7	298.1	290.6	271.3

Accountants' Opinion

To the Shareholders of Northern States Power Company:

We have examined the balance sheets and statements of capitalization of Northern States Power Company (Minnesota) and its subsidiaries as of December 31, 1985 and 1984, and the related statements of income, retained earnings, and changes in financial position for each of the three years in the period ended December 31, 1985. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, such financial statements present fairly the financial position of the Companies at December 31, 1985 and 1984, and the results of their operations and the changes in their financial position for each of the three years in the period ended December 31, 1985, in conformity with generally accepted accounting principles applied on a consistent basis.

DELOITTE HASKINS & SELLS

Minneapolis, Minnesota
February 14, 1986

Report of Management to Shareholders

Management is responsible for the preparation and integrity of the financial statements and representations of this annual report. We believe the financial statements were prepared in accordance with generally accepted accounting principles. Where necessary, management made informed judgments and estimates of the expected results of events and transactions. The financial information throughout this report is consistent with the audited financial statements.

Management depends on the Company's internal accounting control system for accurate financial reporting. This system reasonably assures us that we protected all assets and executed and reported transactions in accordance with our authorizations. We believe the Company's accounting policies and controls prevent material errors and irregularities, and they allow employees in the normal course of their duties to detect inaccuracies within a timely period.

Directors who are not officers or employees make up the Finance-Audit Committee of the Board of Directors. The Committee meets regularly with management, internal auditors and independent certified public accountants to examine and evaluate the Company's internal accounting controls and financial reports. Internal and independent auditors have free access to the Committee, without management's presence, to discuss the results of their audits.

NORTHERN STATES POWER COMPANY

Minneapolis, Minnesota
February 14, 1986

OPERATING STATISTICS

	1985	1984	1983	1982	1981
Electric					
Revenues (thousands)					
Residential					
With space heating	$ 58 309	$ 53 611	$ 48 573	$ 43 931	$ 32 098
Without space heating	425 652	421 894	414 311	376 155	312 258
Small commercial and industrial	236 915	228 802	208 903	196 583	162 848
Large commercial and industrial	515 794	506 906	458 294	423 367	363 332
Street lighting and other	30 734	31 241	30 130	33 276	25 569
Total retail	1 267 404	1 242 454	1 160 211	1 073 312	896 105
Sales for resale	94 605	104 180	111 233	94 152	90 055
Miscellaneous	14 103	15 986	13 943	10 726	11 874
Total	$1 376 112	$1 362 620	$1 285 387	$1 178 190	$ 998 034
Sales (millions of kwh)					
Residential					
With space heating	1 066	980	918	904	764
Without space heating	6 900	6 826	6 923	6 583	6 178
Small commercial and industrial	4 326	4 158	3 901	3 755	3 403
Large commercial and industrial	12 569	12 250	11 443	10 680	10 202
Street lighting and other	500	515	514	672	578
Total retail	25 361	24 729	23 699	22 594	21 125
Sales for resale	4 211	3 947	4 641	4 183	4 659
Total	29 572	28 676	28 340	26 777	25 784
Customer Accounts (at Dec. 31)					
Residential					
With space heating	66 668	62 706	58 426	53 302	49 027
Without space heating	1 010 194	996 997	981 729	972 206	930 664
Small commercial and industrial	125 992	123 783	120 875	118 542	109 603
Large commercial and industrial	6 049	5 816	5 647	5 611	5 387
Street lighting and other	5 245	5 170	5 058	5 275	5 049
Total retail	1 214 148	1 194 472	1 171 735	1 154 936	1 099 730
Sales for resale	81	79	78	84	76
Total	1 214 229	1 194 551	1 171 813	1 155 020	1 099 806
Residential With Space Heating					
Annual kwh per customer	16 522	16 203	16 475	17 588	16 255
Annual revenue per customer	$ 903.72	$ 886.10	$ 871.28	$ 855.10	$ 683.14
Average revenue per kwh	5.47¢	5.47¢	5.29¢	4.86¢	4.20¢
Residential Without Space Heating					
Annual kwh per customer	6 887	6 909	7 114	6 794	6 672
Annual revenue per customer	$ 424.86	$ 427.05	$ 425.75	$ 388.17	$ 337.23
Average revenue per kwh	6.17¢	6.18¢	5.98¢	5.71¢	5.05¢
Kilowatt-hour Output (millions)					
Thermal	24 095	20 627	23 570	21 886	23 041
Hydro	1 200	1 062	1 199	1 144	875
Purchased and interchange	6 317	8 968	5 874	5 740	3 711
Total	31 612	30 657	30 643	28 770	27 627

	1985	1984	1983	1982	1981
Electric—continued					
Capability at Time of Maximum Demand (megawatts)					
Company owned	6 057	5 924	6 071	5 988	6 032
Purchases and sales–net	729	534	530	565	496
Total	6 786	6 458	6 601	6 553	6 528
Maximum Demand (megawatts)	5 205	5 544	5 389	5 222	4 681
Date of Maximum Demand	July 9	Aug. 6	July 21	Aug. 3	July 8

	1985	1984	1983	1982	1981
Gas					
Revenues (thousands)					
Residential					
With space heating	$ 195 722	$ 191 793	$ 184 714	$ 174 037	$ 120 834
Without space heating	3 848	4 274	3 921	3 701	3 465
Commercial and industrial	200 519	202 917	208 173	192 401	144 907
Miscellaneous	2 111	2 981	2 947	3 139	2 789
Total	$ 402 200	$ 401 965	$ 399 755	$ 373 278	$ 271 995
Sales (thousands of mcf)					
Residential					
With space heating	32 850	31 281	29 805	32 588	28 342
Without space heating	464	513	469	540	590
Commercial and industrial	42 028	40 593	41 494	41 426	38 747
Miscellaneous	114	116	79	91	55
Total	75 456	72 503	71 847	74 645	67 734
Customer Accounts (at Dec. 31)					
Residential					
With space heating	255 154	248 335	243 313	238 349	224 832
Without space heating	24 420	25 210	25 555	26 401	27 574
Commercial and industrial	28 414	27 474	26 697	26 350	23 971
Total	307 988	301 019	295 565	291 100	276 377
Residential With Space Heating					
Annual mcf per customer	131	128	124	138	128
Annual revenue per customer	$ 781.64	$ 782.78	$ 768.85	$ 738.14	$ 546.22
Average revenue per mcf	$ 5.96	$ 6.13	$ 6.20	$ 5.34	$ 4.26

SHAREHOLDERS INFORMATION

	1985	1984	1983	1982	1981
Shareholders at year-end	82,234	85,784	90,642	94,108	94,453
Book Value	$ 39.43	$ 36.81	$ 34.15	$ 31.46	$ 29.48
Market Prices					
High	54¾	44¼	40¾	32½	27
Low	41⅛	33⅝	29¾	23⅜	20
Year-end closing	53	41¾	38	30	24⅛
Dividends Declared	$ 3.45	$ 3.17	$ 2.905	$ 2.695	$ 2.525
Earnings per Share	$ 5.93	$ 5.80	$ 5.60	$ 4.79	$ 3.89

Stock Exchange Listings

Common stock is listed for trading on the New York Stock Exchange, the Midwest Stock Exchange and the Pacific Stock Exchange. Its ticker symbol is NSP. The NYSE also lists preferred stock for trading. The Dow Jones newspaper wire service lists the company as NoStPw.

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Dividend Reinvestment and Stock Purchase Plan

Individual shareholders may reinvest common and preferred dividends in shares of NSP common stock under NSP's Dividend Reinvestment and Stock Purchase Plan.

Shareholders also may make cash payments, either on a regular or periodic basis. Each month, NSP's agent, First Trust Company, Inc., will invest the dividends and cash payments in market transactions. The purchase price is the weighted average price at which the agent acquires the shares.

NSP sends participating shareholders a statement after each purchase, detailing the purchase and the shares held. NSP pays any costs, commissions or fees for reinvesting dividends or investing optional cash payments.

Individual shareholders may join the plan at any time by completing an authorization form and returning it to NSP. The booklet and authorization form are available from the Shareholders Department. Shareholders may terminate their participation at any time by written notice to the department.

This information is not an offer to sell nor the solicitation of an offer to buy any securities.

Dividend Payment Dates

Common Stock	*Preferred Stock*
January 20, 1986	January 15, 1986
April 20, 1986	April 15, 1986
July 20, 1986	July 15, 1986
October 20, 1986	October 15, 1986

Stock Information

NSP's Shareholders Department is ready to answer questions about your NSP stock. You can get information by writing to Shareholders Department, Northern States Power Company, 414 Nicollet Mall, Minneapolis, MN 55401, or by calling toll-free (800) 328-8226. From within the Minneapolis-St. Paul area, call 330-5560. Minnesota residents outside the Twin Cities may call toll-free at (800) 292-4149.

Company Publications

Special company publications and information about NSP operations are available from the Communications Department, Northern States Power Company, 414 Nicollet Mall, Minneapolis, MN 55401. Publications cover energy conservation, the environment and electric generation by coal, nuclear and hydropower.

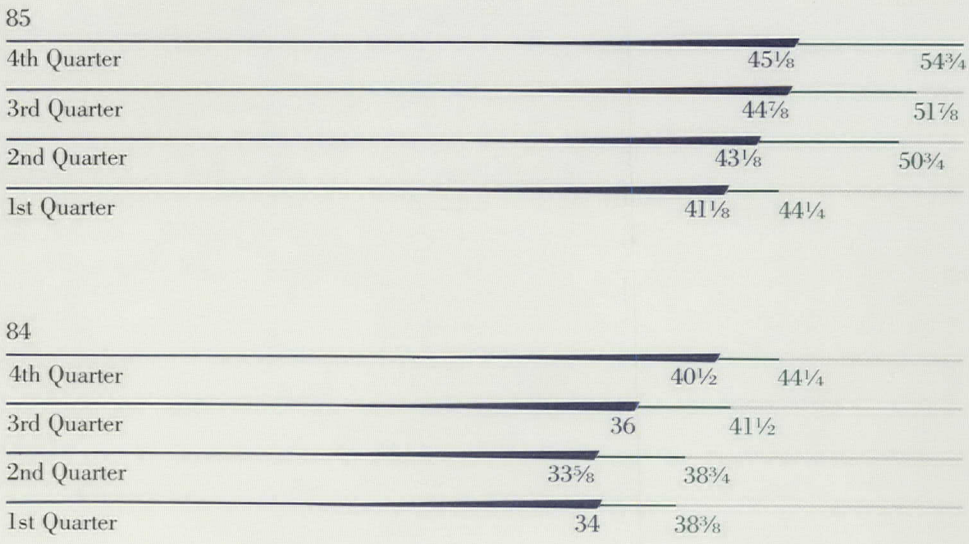
Annual Meeting

NSP invites all shareholders to attend the Company's annual meeting at 10 a.m. Wednesday, May 28, 1986. The meeting will be at the Minneapolis Auditorium, 1403 S. Stevens Ave., Minneapolis, Minnesota. The auditorium, in downtown Minneapolis, is located at the corner of 14th St. and Third Ave.

Quarterly Stock Data

Low

High



Fiscal Agents

Northern States Power Company (Minnesota)

Registrar–Common and Preferred Stocks
Norwest Bank Minneapolis, N.A.
8th and Marquette
Minneapolis, MN 55479

Transfer Agent–Common and Preferred Stocks
Northern States Power Company
414 Nicollet Mall
Minneapolis, MN 55401

Forwarding Agent
Norwest Trust Company, New York
40 Wall St.
New York, NY 10005

Dividend Distributing Agent
Northern States Power Company

Trustee–Mortgage Bonds
Harris Trust and Savings Bank
111 W. Monroe
Chicago, IL 60690

Coupon-Paying Agents–Bonds
Harris Trust and Savings Bank, Chicago
Irving Trust Company
1 Wall St.
New York, NY 10015

Northern States Power Company (Wisconsin)

Trustee–Bonds
First Wisconsin Trust Company
777 E. Wisconsin Ave.
Milwaukee, WI 53202

Coupon-Paying Agents–Bonds
First Wisconsin Trust Company, Milwaukee
Harris Trust and Savings Bank, Chicago
Irving Trust Company, New York

Lake Superior District Power Company

Transfer Agent–Preferred Stock
Northern States Power Company

Trustee–Bonds
First Wisconsin Trust Company, Milwaukee

Form 10-K

You may obtain a copy of NSP's Form 10-K, our annual report to the Securities and Exchange Commission, by writing to Securities Issuance and Financial Reports Department, Northern States Power Company, 414 Nicollet Mall, Minneapolis, MN 55401. A complete statistical supplement to the annual report also is available from this department.

DIRECTORS AND OFFICERS

As of December 31, 1985

Directors of the Minnesota Company

David A. Christensen (50)
President, Raven Industries, Inc.
Manufacturers of reinforced plastics, sportswear and electronic equipment
Sioux Falls, South Dakota

W. John Driscoll (56)
President, Rock Island Company
Private investment firm
St. Paul, Minnesota

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Chief Executive Officer, Gelco Corporation
Transportation leasing, management and corporate services firm
Eden Prairie, Minnesota

Dale L. Haakenstad (57)
Chairman and Chief Executive Officer
Western States Life Insurance Company
Fargo, North Dakota

*Allen F. Jacobson (59)**
President, U.S. Operations,
Minnesota Mining and Manufacturing Company (3M)
Manufacturer of abrasives, adhesives and health-care products
St. Paul, Minnesota

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Chief Executive Officer
Northern States Power Company
Minneapolis, Minnesota

John E. Pearson (58)
Chairman and Chief Executive Officer
Northwestern National Life Insurance Company
Minneapolis, Minnesota

*William G. Phillips (65)**
Retired Chairman, International Multifoods
Food processing and marketing company
Minneapolis, Minnesota

G.M. Pieschel (58)
President, Farmers and Merchants State Bank
Springfield, Minnesota

*Dr. Margaret R. Preska (47)**
President, Mankato State University
Mankato, Minnesota

*D. B. (Rhiny) Reinhart (65)**
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Gateway Foods, Incorporated
Wholesale food distributor
La Crosse, Wisconsin

Bruce A. Richard (56)
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Chief Operating Officer
Northern States Power Company
Minneapolis, Minnesota

*John A. Rollwagen (45)**
Chairman and
Chief Executive Officer
Cray Research, Inc.
Manufacturer of supercomputers
Minneapolis, Minnesota

A. Patricia Sampson (37)
Assistant Chapter Manager and
Manager of Community Services
Minneapolis Area Chapter
American Red Cross
Minneapolis, Minnesota

Chairman Emeritus

Robert H. Engels (75)
Retired Board Chairman
Northern States Power Company
Minneapolis, Minnesota

*Member of Finance-Audit Committee

Principal Officers of the Minnesota Company

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Craig J. Blair (42)
Vice President-Electric Utility

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Joseph A. Cascalenda (55)
Vice President-Public Affairs

James O. Cox (58)
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Edward C. Glass (63)
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Vice President-Nuclear Generation

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Vice President-Gas Utility

Jerald E. McKinney (48)
Vice President-Personnel

Gerald S. Pettersen (54)
Controller

Bruce A. Richard (56)
President and
Chief Operating Officer

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Vice President-Administration

Harry W. Spell (62)
Senior Vice President-Finance

James R. Tacheny (53)
Vice President-System Production, Operation and Maintenance

Directors of the Wisconsin Company

*Member of Audit Committee

*Chauncey H. Cooke (66)**
Farmer
Eau Claire, Wisconsin

*Jean Gitz Bassett (61)**
La Crosse, Wisconsin

*Ray A. Larson Jr. (56)**
President, Wissota Sand and Gravel Company
Eau Claire, Wisconsin

Malcolm McLean (57)
President, Northland College
Ashland, Wisconsin

*D. B. (Rhiny) Reinhart (65)**
Chairman of the Board
Gateway Foods, Incorporated
La Crosse, Wisconsin

Bruce A. Richard (56)
President and Chief Operating Officer
Northern States Power Company (Minnesota)
Minneapolis, Minnesota

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Northern States Power Company (Wisconsin)
Eau Claire, Wisconsin

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Senior Vice President-Finance
Northern States Power Company (Minnesota)
Minneapolis, Minnesota

Edwin M. Theisen (55)
President and Chief Executive Officer
Northern States Power Company (Wisconsin)
Eau Claire, Wisconsin

Principal Officers of the Wisconsin Company

Vincent E. Beacom (56)
Vice President-Commercial and Division Operations

Donald P. Jolstad (56)
Secretary and Assistant Treasurer

John L. Koplin (52)
Treasurer

Richard L. Roehrich (61)
Vice President-Administrative Services

Anthony G. Schuster (41)
Vice President-Power Supply

Edwin M. Theisen (55)
President and Chief Executive Officer

Glenn B. Thorsen (51)
Vice President-Finance

Directors of Lake Superior District Power Company

*Member of Audit Committee

Kendall S. Austin (65)
Retired Board Chairman and Chief Executive Officer
Lake Superior District Power Company
Ashland, Wisconsin

Donald W. McCarthy (63)
Chairman of the Board and Chief Executive Officer
Northern States Power Company
Minneapolis, Minnesota

*Malcolm McLean (57)**
President, Northland College
Ashland, Wisconsin

*P. A. Risberg (68)**
President and General Counsel
Risberg Land Company
Real estate company
Hayward, Wisconsin

Edwin M. Theisen (55)
President and Chief Executive Officer
Northern States Power Company (Wisconsin)
Eau Claire, Wisconsin

*Alfred Wright (69)**
Retired Manager, American Cablevision
Ironwood, Michigan

Principal Officers of Lake Superior District Power Company

Vincent E. Beacom (56)
Vice President-Commercial and Division Operations

Richard L. Roehrich (61)
Vice President-Administrative Services

Anthony G. Schuster (41)
Vice President-Power Supply

Edwin M. Theisen (55)
President and Chief Executive Officer

Glenn B. Thorsen (51)
Vice President-Finance, Secretary and Treasurer

Northern States Power Company
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